

PRECEDENT TERMS

Vincent S. J. Buccola[†]

David A. Hoffman^{††}

This Article argues that many contract terms in deals among sophisticated parties behave in a way existing theory does not capture. These terms matter economically and vary from deal to deal, yet changes in them across deals do not affect price. Because parties cannot reliably estimate the marginal effect of such variation, they cannot (and do not) trade these terms off against price or against one another. The terms are negotiated, often intensely, but bargaining takes a form that existing models of contracting behavior don't contemplate: parties reason from the contents of prior deals, treating the recent past as a presumptive baseline and contesting departures from it.

We develop the logic of this “precedent” mode of contracting and examine its operation in the leveraged-loan market. Interviews with arrangers, borrowers, and investors suggest that many of the provisions over which market participants fight fall into this category. If leveraged loans are not exceptional, then in many transactional settings a substantial share of surplus is allocated on an unpriced, precedent-governed margin that existing models overlook. Recognizing that margin helps explain puzzles in pricing and term evolution and clarifies the work transactional lawyers perform.

[†] Professor of Law, The University of Chicago Law School.

^{††} William A. Schnader Professor of Law, University of Pennsylvania Carey School of Law. We thank Bennett Buntin, Timothy Koo, and Christopher Pingitore for research assistance. For helpful comments we thank Omri Ben-Shahar, Lisa Bernstein, Brian Broughman, Albert Choi, Jill Fisch, Mitu Gulati, Marcel Kahan, Kobi Kastiel, Jon Klick, Joan Neal, Andrew Verstein, and participants at workshops at Chicago, Columbia, Florida, NYU, Penn, and UCLA. We are grateful to our interview subjects for their participation and thoughtful commentary.

CONTENTS

Introduction	3
I. Optimal Contract Theory's Term Binary	9
A. Best Possible Terms	10
B. Boilerplate Terms	12
C. Incongruent Realities	14
II. Precedent Terms	18
A. Definition	19
B. Conditions of Precedent Contracting	21
C. A Precedential Theory of Term Specification	24
III. Precedent Terms in Leveraged Loan Origination	31
A. The Leveraged Loan Market	32
B. Interviews	36
C. Findings	37
1. The Domain of Precedential Contracting	37
2. The Role of Precedent in the Leveraged Loan Market	44
IV. Implications and Extensions	49
A. Implications for Research and Teaching	49
1. Calibrating and Interpreting Empirical Research	51
2. Inferences from (or to) Efficiency	52
3. Sociological (Ethnographic?) Approaches to Contract Formation	53
4. Accounting for Lawyers' Observed Use of Precedents	55
5. Specifying Boilerplate	55
B. Obligatory Nod to AI and the Death of Lawyering	56
Conclusion	58

INTRODUCTION

A common refrain in the trillion-dollar leveraged loan market is that debt contracts today give borrowers unreasonably wide latitude to act contrary to lenders' interests. As investors see it, borrowers and the private equity sponsors who back them have gained too much freedom to jettison collateral, pay dividends, and dilute or even subordinate lenders.¹ Investors and their advisors are not alone in their dismay. Even those who specialize in representing borrowers will sometimes concede, off the record, that the terms they push—and get—favor their clients excessively.

Rueful observations of this sort, as common as they are across a range of contracting environments, are apt to raise eyebrows in the faculty lounge. To those steeped in the lessons of optimal contract theory, something is amiss with such bottom-of-the-well assessments of commercial practice. The notion that many if not most participants in a market could believe that prevailing terms are unreasonable is mysterious, bordering on nonsensical. At least in markets composed of sophisticated repeat players, no one is supposed to have an incentive to propound commercially unreasonable terms.

Indeed, the prevailing taxonomy—explicit in some work and implicit in most—divides contracts into two generic types of economically meaningful non-price term, neither of which can logically give rise to resentment. One kind of term varies from deal to deal and affects the contract's overall price. Idiosyncratic features of any given deal can cause the term's optimal value to vary, but the distributional consequences of variation are captured in price; the contract is, in effect, a bundle of welfare-enhancing trades.² The other kind of term, boilerplate, is uniform across deals and emerges from a path-dependent

¹ For good or ill, loan terms have changed to give borrowers more operational and financial flexibility than they had in the recent past. *See, e.g.,* Victoria Ivashina & Boris Vallée, *Weak Credit Covenants*, 0 MGMT. SCI. 0 (2025) (discussing incurrence covenants and offering suggesting evidence that covenant strength is not priced); Thomas Griffin, Greg Nini & David C. Smith, *Losing Control? The Two-Decade Decline in Loan Covenant Violations*, 0 J. FIN. 0 (forthcoming), ms. *1 (finding “average loan package to U.S. public firms in 2019 contained almost half as many financial covenants as the average loan in 1997 and the covenants that remained were set at looser thresholds.”).

² *See infra* at text accompanying notes 15 through 28.

evolutionary process.³ The term might not ideally suit the idiosyncratic features of each deal, but it allows parties cheaply to settle on a baseline against which they can divide expected surplus. No master of the financial universe complains in the pages of the *Wall Street Journal* about trends in choice-of-law clauses.⁴

Nor are party complaints the only sign that something is missing from the existing theoretical picture. We are not the first to point out persistent facts about real-world contracting that sit uneasily with theory if they don't contradict it outright: the large sums paid to transactional lawyers on mine-run deals;⁵ the pricing of deals before non-price terms are settled;⁶ the persistence of negotiated but evidently suboptimal terms.⁷ There are also epistemic reasons to

³ Network effects can make standardization optimal even though when the standard term fails strictly speaking to maximize parties' notional available surplus. See Marcel Kahan & Michael Klausner, *Standardization and Innovation in Corporate Contracting (or "The Economics of Boilerplate")*, 83 VA. L. REV. 713 (1997). For a general description of the research on boilerplate together with an astute synthesis of modern accounts of its genesis, see Robert E. Scott, Stephen J. Choi and Mitu Gulati, *Commercial Boilerplate: A Review and Research Agenda*, 20 ANN. REV. L. & SOC. SCI. 201 (2024).

⁴ To be sure, a boilerplate term can become obsolete due to changes in the environment to which a deal relates, and when that happens a period of indeterminacy can arise as parties migrate from one standard to another. But that is apt to be a transitory state, since market participants have incentives to coordinate when the conditions hold that give rise to boilerplate in the first instance—i.e., when network economies outweigh potential incremental surpluses available through tailored negotiation.

⁵ Elisabeth de Fontenay, *Law Firm Selection and the Value of Transactional Lawyering*, 41 J. CORP. L. 393 (2015).

⁶ Cf. Joshua Higbee, Cree Jones, Matthew Jennejohn & Eric L. Talley, *Fix the Price or Price the Fix? Resolving the Sequencing Puzzle in Corporate Contracting*, available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=5159164 (providing an alternative model that could justify price-before-terms sequencing); Albert Choi & George Triantis, *The Effect of Bargaining Power on Contract Design*, 98 VA. L. REV. 1665 (2012); Jeffrey Manns & Robert Anderson IV, *The Merger Agreement Myth*, 98 CORNELL. L. REV. 1143 (2013); JAMES C. FREUND, ANATOMY OF A MERGER: STRATEGIES AND TECHNIQUES FOR NEGOTIATING CORPORATE ACQUISITIONS 53-56 (1975) (explaining that lawyers during the first stage of negotiations play a nominal role, with parties negotiating price and key nonprice provisions, often without their lawyers).

⁷ See, e.g., John C. Coates IV, *Explaining Variation in Takeover Defenses: Blame the Lawyers*, 89 CALIF. L. REV. 1301 (2001) (takeover defenses); John C. Coates IV,

wonder about the conventional picture. In particular, the conditions of most commercial markets rule out falsification of the assumption that variation in economically meaningful terms affects price causally.⁸ And where falsification has been attempted, results are mixed.⁹

This article identifies a neglected but important category of contract term for which existing theory has no place. What we call “precedent” terms vary from deal to deal in transactions of a given type but, despite their economic significance, do not influence the contract’s price. Parties know that such terms matter, but for various reasons we will explore, they cannot translate intuitions about their ordinal preferences into a price signal that accords even roughly with the term’s likely economic effect. Under these conditions, a party may be able to appropriate an incremental share of deal surplus if it can change the term marginally to its advantage. That threat, in turn, explains a widely observed but theoretically perplexing style of negotiation based on precedential reasoning—parties argue about what should be in today’s contract largely by reference to what was in yesterday’s.

A concrete example may help. Leveraged-loan agreements routinely include a “most-favored-nation” (MFN) provision limiting the amount by which the yield on any future, incremental debt the borrower might issue can exceed that of the loans being contracted. A typical clause might read:

The Borrower may incur Incremental Term Loans; provided that the All-In Yield applicable to any such Incremental Term Loans shall not exceed the All-In Yield applicable to the Initial Term Loans by more than 25 basis points (the ‘MFN Delta’), unless the

Managing Disputes through Contract: Evidence from M&A, 2 HARV. BUS. L. REV. 295 (2012) (dispute management provisions); John C. Coates, IV, *Allocating Risk Through Contract: Evidence from M&A and Policy Implications* 43 (Aug. 22, 2012) (unpublished manuscript), available at <https://ssrn.com/abstract=2133343> (risk-shifting provisions); Manns & Anderson, *supra* (deal protection provisions).

⁸ See Michael Klausner, *Corporations, Corporate Law, and Networks of Contracts*, 81 VA. L. REV. 757 (1995); Marcel Kahan & Michael Klausner, *Path Dependence in Corporate Contracting: Increasing Returns, Herd Behavior and Cognitive Biases*, 74 WASH. U. L. Q. 347 (1996).

⁹ See *infra* Part I.C.

Borrower increases the All-In Yield on the Initial Term Loans to match such excess.

Market participants know perfectly well that changing this delta from 25 to 50 or 75 basis points would increase lenders' exposure to dilution, especially in distress scenarios. And yet no one—not borrowers, lenders, arrangers, or collateralized loan obligation (CLO) managers—can monetize that marginal change with even approximate confidence. Its consequences are too state-contingent, too intertwined with other terms, and too small relative to noise to be modeled.

The MFN delta therefore varies sharply across deals, is intensely negotiated, and is economically meaningful—yet it does not affect price. Parties fight about it, not because one concession can be traded for another elsewhere in the contract, but because movement in the delta shifts surplus even though no one can say by how much. Merger agreements exhibit the same pattern in the calibration of materiality scrapes and knowledge qualifiers; commercial real-estate leases do so in bespoke carve-outs to assignment and use restrictions. Across these contexts, parties lean heavily on recent deals not as data points for pricing, but as normative anchors for what one may legitimately ask for or resist.

We do not contest the logic of optimal contracting where price sensitivity is present. Our point is that a large, theoretically unacknowledged region of sophisticated contracting operates where price sensitivity does not—and it is in that region that bargaining, surplus division, and lawyerly expertise do their real work. When variation in economically meaningful terms cannot be priced, bargaining does not approximate Coasean trade. It becomes a struggle over unpriced entitlements, governed by precedent, professional norms, and claims of legitimacy. In this domain, the familiar phenomena of “what’s market,” indignation at aggressive asks, and appeals to recent deals are not noise around a price-driven core but the central technology for allocating surplus. Bargaining, in short, resembles analogical, precedent-driven reasoning rather than marginal valuation.

If we are right, the implications for contract theory are straightforward. A substantial amount of economically meaningful action occurs on a margin that the prevailing model does not describe. Recognizing this margin does not displace optimal contracting. It

marks the boundary of the model: where price can no longer discipline variation, parties rely on precedent to structure bargaining and allocate surplus.

Our aim in what follows is to map this domain.

In Part I of this Article, we describe current conceptions of the production of commercial contracts. The punch line is that the literature lacks a notion, or at least a coherent account, of the persistence of unpriced terms that vary across contracts.¹⁰

Part II offers our theoretical contribution. Beyond precisely defining precedent terms, we discuss the conditions under which they can be expected, their empirical markers and their implications for efficiency and surplus division. For now, it's enough to say that precedent contracting arises when parties can't assign a price increment to a marginal change in a particular term but heterogeneity in the parties or their circumstances precludes standardization.¹¹ This can happen when negotiations are sequenced, with price being settled before ancillary terms; or when complexity precludes the kind of calculation that theorists often presume. In the merger context, for example, consider a seller's representations about the quality of its business. The unique features of each company—or at least of a substantial fraction of companies—might be important enough to rule out boilerplate representations, but assigning a price to more or less stringent representations may nevertheless be infeasible even if deal consideration were not already agreed.¹²

When quantitative assessments fail, such that division of surplus is at stake, market participants turn to normative argumentation. They

¹⁰ The closest thing to such an account involves the recognition of agency costs between contract parties and the lawyers who represent them. We discuss *infra* important research on this topic from Coates, Anderson and Manns, and de Fontenay. Although their insights are part of any comprehensive account of contract production, we do not think agency problems can explain the persistent and widespread patterns that we seek to account for.

¹¹ The attentive reader will notice that the distinctions between best possible, precedent, and boilerplate terms are mutable. For example, a precedent term might over time become boilerplate (as negotiating parties settle on an acceptable standard) or best possible (as parties, through accumulation of experience or otherwise, learn to price variation).

¹² In fact, merger and acquisition agreements are a well-known example of a deal type the negotiations with respect to which typically sequence agreement on price before ancillary terms. See *generally* Higbee *et al.*, *supra* note 6, for a discussion.

identify and contest the meaning and authority of precedents. To parties negotiating an acquisition, the representations made in recent acquisitions of similar companies are not decisive, but they do place a burden of persuasion, so to speak, on the party who would demand materially weaker or stronger representations in the present deal.¹³ The fact that transactional lawyers use past deals as guides is widely known.¹⁴ Our account explains the practice as a strategy to prevent unraveling, keep expropriation within bounds, and ameliorate the prospect of deadlock.

Part III makes the theory concrete by illustrating its application to one important contracting context, the origination of leveraged loans. Drawing on interviews with leading figures in the leveraged loan ecosystem, we find that precedent contracting is everywhere and identify features of the market—participants, market structure, nature of the borrowers—that help to explain its persistence. We discuss how would-be borrowers and lenders identify and ultimately settle on the value that precedent terms will have in a particular deal, showing how they use precedential shortcut—“what’s market”—to channel discussions in the absence of a price mechanism.

Part IV suggests the importance of sharpening the differences between the three types of terms we’ve identified. For one thing, knowing that there is a persistent category of dickered but unpriced terms should make us less confident that we really know what kind of terms and what kind of markets are priced: more data and better theory are needed. What’s at stake is the distribution of the surplus that transactional engineering creates: someone, in short, is reaping the benefits of the absence of explicit price signals, and our work is a call to identify winners and losers. We also ask whether technological disruption has the potential to disrupt current equilibria: as the costs of

¹³ Failure of the price mechanism does not logically imply that precedent should have normative force. Parties could negotiate entirely in other registers, for example in terms of efficiency or fairness. In fact, however, assigning a weight to the status quo—incrementalism—has long proved a compelling decision framework when the costs of assessing many alternatives are high. *See infra* notes 53 through 81 and accompanying text.

¹⁴ *See, e.g.*, Robert Anderson & Jeffrey Manns, *The Inefficient Evolution of Merger Agreements*, 85 GEO. WASH. L. REV. 57 (2017) (documenting the use of past deals as templates by transactional lawyers in the M&A space).

learning about complex systems fall, how will deal intermediaries seek to persist in maintaining their precedent-driven positions?

I. OPTIMAL CONTRACT THEORY'S TERM BINARY

Few questions are as central to the study of commercial law as determining how contractual parties settle on terms. Knowing how to answer that question bears not least on the optimal scope of a variety of legal doctrines.¹⁵ The pragmatics of rules of construction and the application of doctrines such as unconscionability and the covenant of good faith and fair dealing, for example, often turn on assumptions about how contracts are produced.

The optimal contracting literature posits two answers corresponding to two generic kinds of terms that are assumed (usually implicitly) to exhaust the subject.¹⁶ Contracts for a particular type of deal consist of, on one hand, terms that vary from contract to contract and which are reflected in the deal price and, on the other hand, those that are essentially uniform across contracts. The variable terms, whether actively negotiated or not, reflect at least one party's judgment of the way to achieve the maximum surplus available as between the parties; while the invariant terms—boilerplate—reflect the output of a social learning process that eschews deal-specific tailoring in favor of network economies that arise from scale.

Despite the power of the insights that underlie the taxonomy, however, the picture of contracting that emerges does not always fit easily with on-the-ground realities. This Part describes the theory briefly for the unfamiliar reader and then outlines difficulties with it.¹⁷ Some challenges the theory can more easily accommodate than others. But something is missing.

¹⁵ Recently this point has been argued especially in relation to consumer contracts. See, e.g., David A. Hoffman & Rick Swedloff, *Insurers as Contract Influencers*, MINN. L. REV. ____, 45-48 (forthcoming 2026), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=4909398.

¹⁶ The sociological theory is less definitive but draws on many of the same concepts. See, e.g., Mark C. Suchman, *The Contract as Social Contract*, 37 *LAW & SOC'Y REV.* 91 (2003).

¹⁷ The relevant research has typically focused on one or another specific context. There has been until recently surprisingly “little empirical work on the overall legal drafting process in transactional law.” Anderson and Manns, *supra* note 14, at 59.

A. *Best Possible Terms*

The roots of optimal contract theory are Coasean. Coase's observation that, absent transaction costs, people would exchange entitlements in a joint-value maximizing fashion can be applied to the content of highly articulated contracts as much as to the existence of one-off exchanges.¹⁸ If prospective counterparties are able, they will assign future decision rights that affect their joint returns to the party best positioned to make the maximizing decision, and then use a price term to divide the resulting surplus.¹⁹ The terms that emerge from such a process can be expected to vary even across deals aiming at the same rough aims. Idiosyncratic features of the parties, of the subject of their contract, and of the macroeconomic environment in which the relationship is expected to unfold each matter and may interact in surprising ways.²⁰ The theory says only that, absent transaction costs, the parties will settle on what for them are the *best possible terms*.

An important extension recognized that pricing could achieve much the same end as explicit negotiation. At least with respect to complex commercial relationships, there are not many situations in which potential counterparties can bargain costlessly (or with minimal friction). The Coasean framework therefore has little to say directly about, for example, capital markets transactions, in which one party offers a contract to many potential counterparties whose identities it may not even know. If, however, potential buyers of such a contract assign a private value to the proposed contract's terms, and if the contract's price can adjust to reflect buyers' demand, then contracts should mimic the Coasean ideal with little, or indeed no, explicit negotiation.²¹ The price term forces the seller to internalize the anticipated consequences of the terms it propounds: more seller-friendly terms mean a lower price; more buyer-friendly terms, a higher

¹⁸ R.H. Coase, *The Problem of Social Cost*, 3 J. L. & ECON. 1 (1960).

¹⁹ Philippe Aghion & Patrick Bolton, *An Incomplete Contracts Approach to Financial Contracting*, 59 REV. ECON. STUD. 473 (1992).

²⁰ See, e.g., Albert Choi and George Triantis, *Market Conditions and Contract Design: Variation in Debt Contracting*, 88 N.Y.U. L. REV. 51 (2013).

²¹ Michael C. Jensen & William H. Meckling, *Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure*, 3 J. FIN. ECON. 305 (1976).

price.²² Under these conditions, the seller does best by calibrating each term to its optimum, just as though the seller and prospective buyers had actually discussed terms.²³

An immense literature in the law and economics of commercial contracts follows from, or assumes the overriding importance of, this price mechanism.²⁴ The “race to the top” line of argument in corporate law is perhaps the most conspicuous application of the logic.²⁵ But it is a staple of the commercial contracts and corporate finance literatures generally. This is not to say that most contract theorists believe that

²² *Id.*; see also Ronald J. Gilson & Reinier H. Kraakman, *The Mechanisms of Market Efficiency*, 70 VA. L. REV. 549 (1984); Marcel Kahan, *The Qualified Case Against Mandatory Terms in Bonds*, 89 NW. U. L. REV. 565, 575 (2005) (“As long as the legal terms are accurately priced when a bond is issued, other forms of mispricing will not distort the company’s incentives to include wealth-maximizing legal terms”).

²³ This is so at first approximation anyway. Absent negotiation, the seller has to guess how the buyers will value proposed terms. And the parties may have different information or beliefs. So, the seller proposes terms that reflect some combination of what it thinks and what it perceives that buyers will think are the optimal terms.

²⁴ For an arbitrarily selected taste of the literature, see Richard Craswell, *Passing on the Costs of Legal Rules: Efficiency and Distribution in Buyer-Seller Relationships*, 43 STAN. L. REV. 361 (1991) (analyzing the relationship between contract terms and consumer demand as a function of price); cf. See Matthew D. Cain, Jill E. Fisch, Sean J. Griffith & Steven Davidoff Solomon, *How Corporate Governance Is Made: The Case of the Golden Leash*, 164 U. PA. L. REV. 649, 657 (2016) (“Corporate governance research has . . . focused on the empirical question of whether and how particular governance terms are priced as a necessary first step in answering whether particular governance provisions are good or bad. Unfortunately, whether and how the market prices corporate governance remains subject to dispute, as a review of the recent literature shows.”); Victoria Ivashina & Anna Kovner, *The Private Equity Advantage: Leveraged Buyout Firms and Relationship Banking*, 24 REV. FIN. STUD. 2462, 2463 (2011) (suggesting leveraged loans are unlikely to be well priced).

²⁵ Ralph K. Winter, Jr., *State Law, Shareholder Protection, and the Theory of the Corporation*, 6 J. LEGAL STUD. 251 (1977); FRANK H. EASTERBROOK & DANIEL R. FISCHEL, *THE ECONOMIC STRUCTURE OF CORPORATE LAW* 15 (1991) (“All the terms in corporate governance are contractual in the sense that they are fully priced in transactions among the interested parties. They are thereafter tested for desirable properties; the firms that pick the wrong terms will fail in competition with other firms competing for capital.”); Frank H. Easterbrook & Daniel R. Fischel, *The Corporate Contract*, 1989 COLUM. L. REV. 1416, 1430 (arguing that all corporate governance terms are priced).

actual contract terms are in fact ideal.²⁶ The syllogism connecting even a perfectly sensitive price mechanism to ideal contracts is not airtight. Frictions such as regulatory mandates, agency costs, and imperfect information mean that The Perfect ought not to be expected. Still, the assumption that contract prices are sensitive to variation in non-price terms, and that price differentiation has a benign effect on term selection, is the starting point for analysis.²⁷ Best possible terms thus are not platonically ideal but rather can vary from contract to contract and have a causal effect on the contract's price.²⁸

B. Boilerplate Terms

Scholars immersed in actual commercial contracts soon noticed that they posed a challenge to the prevailing framework. Little of the typical contract appears to be tailored to the deal's idiosyncratic circumstances. Most of the terms in a bond indenture or real estate lease or M&A contract are identical to—or anyway have very similar practical meaning as—the like terms in all the other contracts of the same sort.²⁹ Boilerplate provides most of the words in most of the contracts. This was odd. If parties can price terms accurately, and if deals have idiosyncratic features that give rise to variation in the optimal allocation of rights, then why do parties cut-and-paste so much?

In the 1990s, pioneering work by Michael Klausner and Marcel Kahan sought to explain standardization from within a rational choice

²⁶ See Harold Demsetz, *Information and Efficiency: Another Viewpoint*, 12 J. L. & ECON. 1 (1969).

²⁷ See, e.g., Adam B. Badawi & Elisabeth de Fontenay, *Is There a First-Drafter Advantage in M&A?*, 107 CAL. L. REV. 1119, 1126 (2019) (describing non-price terms as “components of the bargain intended to create value for one or both parties,” to be split by the price terms).

²⁸ “A corollary of the prediction that parties to a voluntary agreement will inevitably agree to efficient non-price terms is thus that other factors, such as bargaining power, the negotiation process, and negotiating skill, have no effect on the final non-price terms. This ‘irrelevance proposition’ ... has been a defining feature of much of the study of contracts in law and economics.” *Id.*, at 1127.

²⁹ For an illuminating debate on how standardization may differ across different markets, compare Tara Chowdhury, Faith Chudkowski & Mitu Gulati, *The Form Knows Best*, 79 U. MIA. L. REV. 607 (2025), with Glenn D. West, *The Form Doesn't Know Anything: A Response to Chowdhury, Chudkowski and Gulati*, 79 U. MIA. L. REV. 627 (2025).

framework.³⁰ Their influential account did not contest the power of the price mechanism to discipline term selection, but rather explained why it could be wasteful to tailor terms to deal-specific circumstances. The core observation was that it is costly to deal with variation and ambiguity in the meaning of contract terms. Neither a party nor its lawyers can foresee perfectly how counterparties might use, or courts might interpret a novel provision. Such uncertainty reduces the transaction's appeal. Lawyers can ameliorate the problem through careful drafting, but negotiation too is costly. The parties must therefore trade off the benefits of tailoring any particular term to their circumstances against the costs of doing so.

For many dimensions of a typical deal, the value-maximizing approach will be to use the term that others have used (the meaning of which is thus better understood). The resulting network economies mean that path dependence—what others have done before—plays a role in term selection. In this account, standardization is part of optimal contract theory, not a deviation from it. Boilerplate terms result when learning effects are more important than deal-specific tailoring; best possible terms result when the opposite is true.

Standardization and associated aberrations have occupied a large share of contracts scholars' energy ever since.³¹ We are continuing to learn about what gets standardized, how it happens, and so on. Everyone now recognizes that copy-pasting, as imperfect as it may be, is an important part of contract production in commercial markets.³² Mitu Gulati and various co-authors have documented a lot of funny things that persistent agency costs between parties and their counsel alone can explain. Errors creep into terms, lawyers borrow from their last precedents, and they refuse to make changes to the errors even when it seems obvious that this may create landmines in future litigation contexts.³³ But Kahan and Klausner's insight about the

³⁰ Michael Klausner, *Corporations, Corporate Law, and Networks of Contracts*, 81 VA. L. REV. 757 (1995); Marcel Kahan & Michael Klausner, *supra* note 8, at 349.

³¹ For a helpful guide, *see generally* Scott, Choi & Gulati, *supra* note 3.

³² *See, e.g.*, Robert Anderson, *The Evolution of the Poison Pill*, J. CORP. L. (forthcoming); Robert Anderson & Jeffrey Manns, *Boiling Down Boilerplate in M&A Agreements: A Response to Choi, Gulati, & Scott*, 67 DUKE L.J. ONLINE 219 (2019).

³³ Robert E. Scott, Stephen J. Choi & Mitu Gulati, *Contractual Landmines*, 41 YALE J. REG. 307 (2024).

network effects of standardization continues to provide the analytical framework for research and teaching.

C. *Incongruent Realities*

To say that a term binary pervades the theory literature is not to say that scholars who study commercial contracts have found the resulting picture entirely satisfactory. On the contrary, researchers have raised at least five difficulties or anomalies that the theory produces when the world confronts it.

Price Differentiation Resists Falsification. One weakness of the binary is that it is not easily falsified. Specifically, it is not easy to test the assumption that variation in economically meaningful terms always or nearly always affects price.

Even market skeptics would agree that, in dealings among sophisticated commercial parties, at least some non-price terms affect a contract's price. Thus, finding price impact of the very most important provisions doesn't provide traction in understanding the comprehensiveness of "best possible" contracting. More to the point are studies of price differentiation with respect to secondary or even tertiary terms. Marcel Kahan's work collecting several examples of legal terms in bonds being priced, from super poison put provisions to provisions describing dividend rights, is a useful example.³⁴ Recent studies of stock price changes after a shock to the meaning of a common M&A agreement provision and of sovereign bond price changes after a shock to prevailing contract interpretation likewise offer evidence that investors differentiate according to secondary terms.³⁵

³⁴ Marcel Kahan, *The Qualified Case Against Mandatory Terms in Bonds*, 89 NW. U. L. REV. 565, 575-76 (1995); *id.* at 621 ("Though the direct evidence on pricing [of publicly issued bonds] is sparse, there do not appear to be substantial imperfections in the pricing of legal terms: the bulk of the relevant studies shows that legal terms are priced and that the market for newly issued bonds works well.").

³⁵ Dhruv Aggarwal, Albert H. Choi & Geeyoung Min, *Contractual Remedies in Mergers: Lessons from Crispo v. Musk*, University of Michigan Law School Law & Economics Working Paper 272 (2024) (acquisition agreements); Stephen J. Choi, Mitu Gulati, Ugo Panizza, Robert E. Scott & Mark C. Weidemaier, *Obscure Contract Terms: An Inadvertent Pricing Experiment*, 19 CAP. MKTS. L.J. 230 (2024) (sovereign bonds).

But research designs are unavoidably imperfect, and the evidence is hardly overwhelming.³⁶ In many contexts, noise in the price data precludes falsification even with respect to term variation that is obviously meaningful in a fundamental economic sense. Consider work that looks at the implicit price of a loan term that makes lenders susceptible to a structurally coercive renegotiation offer called an “uptier.” The researchers took advantage of a shock to contract meaning to identify variation in the stock of outstanding loan contracts, some of which were susceptible to an uptier and some of which were not. Despite a clean natural experiment and high stakes, the paper could draw no confident inference that susceptibility was priced at all.³⁷

Persistently Common Terms Seem Bad. Another vein of criticism arises from the persistence of negotiated terms that seem to be inefficient. Part of the logic of the best possible is that parties seek to maximize surplus. If one is confident enough that a common (but not boilerplate) term fails that test, then so much the worse for the theory’s hegemony.

This line of reasoning is devastating for extreme “race-to-the-top” theories, but it need not imply that parties fail to price differentiate term variation. In the corporate governance context, for example, John Coates and others have offered agency-cost stories to explain what they see as self-evidently inefficient variation.³⁸ Observing takeover defenses in the wild that he found to be suboptimal, Coates told readers to blame the lawyers:

Corporate lawyers, at least at the IPO stage, appear to be working relatively free of market, ethical, or other constraints, and many appear to be making choices, and mistakes, without determining whether such choices are in the long-term interests of their clients.³⁹

³⁶ See, e.g., Manns & Anderson, *supra* note 6, at 1150, 1186 (suggesting lack of pricing evidence for some merger terms).

³⁷ Adam B. Badawi, Vincent S.J. Buccola & Greg Nini, *Price Discipline for Non-Price Loan Terms* (Aug. 31, 2024) (unpublished manuscript), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=4799858.

³⁸ Coates, *supra* note 7; William W. Clayton, *High-End Bargaining Problems*, 75 VAND. L. REV. 703 (2022) (observing agency cost issues in bargaining in private equity funds).

³⁹ Coates, *supra* note *supra* note 7, at 1303.

Other scholars, motivated by similar observations of the merger market, have suggested that deal lawyers inefficiently churn terms to their own benefit instead of seeking the benefits of standardized term sheets.⁴⁰ Such stories, if they are to be believed, do not necessarily refute the notion that parties price variation in economically meaningful terms. But they cast doubt.

Lawyers Are Paid a Lot. The prospect of agency costs underscores another puzzle that orthodox theory poses. Transactional lawyers are paid a lot of money. It is not obvious why they should be, at least in deals of ordinary complexity, if parties can price terms at low cost.

Ron Gilson long ago offered a suite of explanations. On Gilson's account, which others have developed in important ways, lawyers produce value by helping parties approximate a frictionless world of exchange.⁴¹ Information costs plague parties who would like to transact, and lawyers earn a normal return for improving the quality of the deal that will be struck. Some of the ways they may do so are in harmony with optimal contract theory. For example, lawyers may act as "transaction cost engineers," designing terms that will ameliorate conflicts among principals.⁴² They are apt also to be experts in boilerplate and its limits.⁴³ That is, lawyers are the people who embody the network economies associated with standardization. In this story, lawyers are valuable because they have an absolute advantage in understanding the meaning of contract language, including its practical ambiguities, and can thus protect principals from unforeseen risks improve risk allocation.

The transaction cost engineer story is fine as far as it goes. Doubtless lawyers create surplus. To the extent they do, their being compensated is no great mystery. At the same time, the great sums parties spend on counsel, even in mine-run transactions, is striking if they can estimate the value of terms reasonably accurately. Not every contract calls for engineering the Hoover Dam. Something else—something not so easily reconciled with best possible or boilerplate

⁴⁰ Anderson & Manns, *supra* note 17.

⁴¹ Ronald J. Gilson, *Value Creation by Business Lawyers: Legal Skills and Asset Pricing*, 94 YALE L.J. 239 (1984).

⁴² *Id.*; see also Lisa Bernstein, *The Silicon Valley Lawyer as Transaction Cost Engineer*, 74 OR. L. REV. 390 (1995).

⁴³ De Fontenay, *supra* note 5, 405.

contracting—seems to be at play. And Gilson and others have also speculated as much. Part of what transactional lawyers are paid to do is mediate aspects of a negotiation when value is hard for parties to assess.⁴⁴

Normative Judgments Are Pervasive. Casual observation of contract negotiations and the people who negotiate professionally both suggest that dealmaking has a normative component. Parties or their agents routinely present arguments to one another about non-price terms. They make contentions about what the other party should do or be willing to accept—and not only on the ground that the proposed path would maximize joint surplus. Professional negotiators report frustration about overly aggressive or recalcitrant counterparties and elation about their own ability to secure favorable terms for a client.

Normativity concerning non-price terms is hard for standard theory to make sense of. If terms affect price, then parties should want to share information that might lead to the discovery of value-enhancing ideas; but ultimately a party that insists on a bad idea pays for it. Term selection in a best possible contracting framework is like sharing a cake. No one should care deeply about who cuts as long as the other party or parties choose the slices. And variation in many contract terms, even very important terms, is, in fact, a source of indifference. No one minds, for example, when a corporate issuer declares it wants to sell 8-year, not 6-year notes. But the theory predicts indifference for variation in all terms. There should be no hard feelings.

Puzzling Patterns in Term Selection. Several recent papers have identified contexts in which patterns in the selection of variable terms—that is, non-boilerplate terms—change in ways that price discipline does not seem to account for.⁴⁵ None proves a defect in the

⁴⁴ Gilson, *supra* note 43; *see also, e.g.*, de Fontenay, *supra* note 5; Ronald J. Gilson & Robert H. Mnookin, *Foreword: Business Lawyers and Value Creation for Clients*, 74 OR. L. REV. 1, 8-9 (1995); Scott R. Peppet, *Contract Formation in Imperfect Markets: Should We Use Mediators in Deals*, 19 OHIO ST. J. ON DISP. RESOL. 283, 34 (2004) (noting role of lawyers as finders in transactions who obfuscate pricing expectations).

⁴⁵ Vincent S.J. Buccola & Greg Nini, *The Loan Market Response to Dropdown and Uptier Transactions*, 53 J. LEGAL STUD. 489 (2024) (documenting change in contractual susceptibility to uptiers); *cf.* Badawi, Buccola & Nini, *supra* note 39 (failing to find price differentiation with respect to susceptibility); *see also* Jens Frankenreiter, *The Other Delaware Effect* (March 12, 2025),

theory in any strong sense. But the findings don't follow from standard theory, in which contract proponents select terms in the face of price pressure.

A notable example is Roberto Tallarita's recent study of the charter provisions that underpin dual-class share structures.⁴⁶ Tallarita documents and seeks to explain the development over time of terms adopted in contemplation of an initial public offering. He observes something puzzling. The key terms don't seem to reflect heterogeneity among the offering firms. Instead they cluster around standard values at any given time and then move sharply to new standards.

Tallarita's account fits neither the best possible nor boilerplate contracting mold. Standardization in the cross section is consonant with boilerplate, but, as Tallarita reasons, boilerplate theory doesn't explain the pattern well. The relevant terms have clear meaning, are easy to change, and, because they entrench pre-IPO managers to greater or lesser degrees, are obviously important to the fundamental value of a share. Nor can agency costs easily explain the pattern, since, for some of the same reasons, it's implausible to think that lawyers could hide the failure of their handiwork from controlling stockholders, on the one hand, and asset managers, on the other. The terms and their significance are transparent. Tallarita concludes that "market norms" independent of price best account for the attributes of dual class contracting he observes—compression, stickiness and punctuated equilibrium.⁴⁷

II. PRECEDENT TERMS

Our contention is that a third type of term deserves a place in the prevailing analytical framework. This part takes up the conceptual task of developing the "precedent" term. The aim is to say what a precedent term is, how it compares to best possible and boilerplate terms, delimit the conditions under which parties might opt for market contracting, and discuss the relationship between market contracting and other forms of legal argumentation.

https://papers.ssrn.com/sol3/papers.cfm?abstract_id=5115285; Roberto Tallarita, *Dual-Class Contracting*, 49 J. CORP. L. 971 (2024).

⁴⁶ Tallarita, *supra*.

⁴⁷ *Id.* at 1031–40.

A. Definition

What we call a precedent term is an economically significant dimension of contractual meaning relevant to a particular type of transaction (1) the value of which varies across deals and (2) the variation in which parties do not expect to be reflected in the price term.⁴⁸ In combination, these qualities mean that precedent terms affect the distribution of surplus between parties without passing through the price channel that the theory expects. This is our central claim: a substantial share of economically meaningful variation in many sophisticated markets lies on an unpriced margin. It is this margin, not the priced one, that organizes bargaining behavior.

The distinctive features of precedent terms are most easily understood in comparison to best possible and boilerplate terms. Precedent and best possible terms are similar in the sense that they are ubiquitous in contracts for a given deal type but vary in content. Think about a breakup fee in a merger agreement. If an acquisition fails to close other than for certain agreed reasons, the target will have to pay the acquirer an agreed amount of cash. How much it will have to pay, though, and which conditions release the target from its obligation, are deal-specific matters. Precedent and best possible terms are unlike in the relationship between their value and the contract's price term. A variable term is a best possible term if parties anticipate that its value will partially determine the contract's price term; it is a precedent term if they don't.

⁴⁸ Precedent terms is a sometime-used phrase in the literature. *See, e.g.*, John F. Coyle and Joseph M. Green, *Startup Lawyering* 2.0, 95 N.C. L. REV. 1403, 1412 (2017) ("The model docs have led to more standardized terms, which is wonderful service . . . They create a sense of precedent terms, which is one of the most powerful concepts in transactions generally.")

		Variation Price Differentiated?	
		Y	N
Negotiated Variation?	Y	Best Possible	Precedent
	N		Boilerplate

Precedent and boilerplate terms relate to one another inversely to the way best possible and precedent terms do. Precedent and boilerplate terms differ in the sense that a boilerplate term—choice of law, say—has a constant value across contracts (virtually all financing agreements choose New York law).⁴⁹ They are similar in that parties do not think that the term’s value affects the contract’s price term.⁵⁰

Note that precedent terms alone are *contested* terms.⁵¹ Boilerplate terms are not contested because they don’t vary (or don’t matter). Best possible terms are not contested because the “losing” party adjusts its bid or ask accordingly. Precedent terms are contested because, absent contest, the contract’s proponent would seek to make the terms more favorable to itself without anticipating having to pay for the advantage.

As the Introduction suggests, and as the definition above implies, many contracting environments contain a sizable domain in which variation cannot be priced at the margin. What follows in this Part

⁴⁹ Cf. John F. Coyle, *A Short History of the Choice-of-Law Clause*, 91 U. COLO. L. REV. 1147 (2020); John F. Coyle, *Canons of Construction for Choice-of-Law Clauses*, 92 WASH. L. REV. 631 (2017). Boilerplate, in choice of law or otherwise, doesn’t imply that the term is literally identical in every contract.

⁵⁰ The notion of price differentiation is arguably meaningless in relation to boilerplate terms. Price *can’t* vary because the term’s value is constant across deals. Its value might, of course, affect the expected surplus of the average deal. Indeed, the economic theory of boilerplate aims to show how that could be. The relevant point for our purposes is only that parties don’t price differentiate contracts according to the value of boilerplate terms. Parties notionally could price differentiate precedent terms but actually don’t.

⁵¹ This implies that precedent terms are also salient terms and not credence goods.

elaborates how that domain arises, why it persists, and how it interacts with best-possible and boilerplate terms. The point is to show how the unpriced margin shapes how parties negotiate and how surplus ultimately moves between them.

B. Conditions of Precedent Contracting

Conditions in the contracting environment determine which terms will be best possible, precedent, or boilerplate. Precedent terms, in particular, are likely to emerge only where and to the extent that two conditions hold.

First, parties in the market must believe that they are unable effectively to assign a price increment to marginal changes in the term's value.⁵² The impediment to price differentiation varies by market. Regulatory price fixing might do the trick, for example. If parties are prohibited from altering their price term, they can't easily adjust the contract to respond to a marginal change in other terms.⁵³ The chronological process of contracting can likewise inhibit price differentiation. It is customary in some types of M&A deal, for example, for parties to agree to a term sheet that settles consideration before lawyers hash out most of the non-price terms. Process might thus prevent price adjustments even if the law doesn't legally bar it.⁵⁴

An assumption commonly made by economically oriented legal scholars rules out what may be the most important impediment to price differentiation, namely parties' inability to compute (or estimate within reasonable bounds) the effect of a marginal change in a term's value on their expected net wealth. Standard theory assumes away this difficulty. But the same challenges to causal inference that plague academic research also limit the ability of economically interested parties, even those with extensive historical data, to draw conclusions about a term's expected value. The complexity of interactions among contract terms

⁵² Our analysis builds on the literature on effects of the costs of ascertaining good characteristics, built by Yoram Barzel, *Measurement Cost and the Organization of Markets*, 25 J. LAW ECON. 26 (1982)

⁵³ Of course, parties might substitute another non-price margin for the regulated price, and adjust it, in which case the regulation is illusory. But using something other than currency is not always easy.

⁵⁴ See Cathy Hwang, *Deal Momentum*, 65 UCLA L. REV. 376 (2018); de Fontenay, *supra* note 5, at 410 (on staging in M&A).

as well as between the contract and the world beyond may leave parties shrugging at the impact of a change in any one provision even if they can see plainly that the change favors one or another party.⁵⁵

Nor are the problems of complexity limited to the parties to a particular deal. Would-be arbitrageurs who could induce rationality indirectly, through a relative-value trading strategy, may themselves be unable to compute value with enough conviction, and express beliefs through trades cheaply enough, for the project to be worthwhile. Simply put, no one may have sufficiently granular traction to know what the contribution of individual term changes really should be.

Still, the conventional academic assumption marks an important limit on the domain of precedent terms. The more economically important an individual term—the bigger its expected “effect size”—the easier and more desirable it will be for parties to rough out an estimate of value. One should thus anticipate that the most economically consequential dimensions of a transaction will be embodied in best possible rather than precedent terms. Precedent terms are more likely to emerge when multiple pieces of a deal interact in complicated and contingent ways.

Second, parties must perceive that standardization of the term would be undesirable. One response to parties’ inability to price differentiate with respect to a term is to get rid of the term’s variation. Standardization does not always produce network and learning benefits, but it does reduce the number of items that parties need to consider. Moreover, deadweight haggling losses should be most

⁵⁵ Authors who have studied a specific contracting environment carefully have been less likely to make strong assumptions about price differentiation. See, e.g., Marcel Kahan, *The Qualified Case Against Mandatory Terms in Bonds*, 89 NW. U. L. REV. 565, 574 (1995) (concluding, in a study of corporate bonds, that evidence is consistent with many terms being inaccurately or not at all priced); Lucian A. Bebchuk & Kobi Kastiel, *The Untenable Case for Perpetual Dual-Class Stock*, 103 U. VA. L. REV. 585, 623–24 (2017) (speculating that IPO investors may be unable to price variation in the specifics of a dual-class sunset provision); Kenneth Ayotte & Christina Scully, *J. Crew, Nine West, and the Complexities of Financial Distress*, 131 YALE L.J. F. 363 (2021) (arguing that bounded rationality should play a role in evaluations of complex financial instruments because “[c]ontracting parties, no matter how sophisticated, cannot possibly imagine and contract to prevent all possible loopholes that other sophisticated parties might exploit. More importantly to the study of bankruptcy, parties cannot anticipate all possible interactions between their contract and the multiplicity of contracts and rights it will encounter in financial distress.”).

profound with respect to terms that negotiating parties anticipate will not be priced, since each party might (correctly) perceive that it will not need to pay for pushing the term in its favor. Such terms may thus be especially prone to standardization.

Standardization has its costs, however. For one thing, coordinating is costly and subject to free riding incentives. If the benefits of standardization will accrue to the many parties who might undertake a transaction over time, none may have incentive to take on the burden. Trade associations and informal lawyer networks can ameliorate market failure in this respect.⁵⁶ Still, coordination may not be a trivial matter.

The more important costs of standardization, however, are non-pecuniary, and arise from fundamental heterogeneity in features of the deal type. Everyone who wants to make a merger agreement or an IP license or a commercial real estate lease wants to accomplish the same kind of end—to change control of a business or be allowed to use a patented invention or move to a new office. But they may differ in important ways on margins implicated by one or more terms of a prospective deal.⁵⁷ Changing macroeconomic conditions can alter the sensible allocation of a deal’s inherent risks even when the parties and subject matter are constant.⁵⁸ Fitting all prospective parties to a procrustean bed might seem a waste. Market participants might conclude that allowing a term to vary deal-to-deal will maximize total surplus even if they recognize that calculating the surplus, in the aggregate or in any individual contract, is a hopeless prospect.

In principle, parties could “barter” terms without explicitly pricing them—loosening one covenant while tightening another, or softening a representation in exchange for a stronger closing condition. But bartering presupposes the very condition our account denies: that parties can always roughly (if noisily) translate movement along one

⁵⁶ Robert Bartlett, *Standardization and Innovation in Venture Capital Contracting: Evidence from Startup Company Charters* (Stan. L. & Econ. Olin Working Paper No. 585, 2023), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=4568695.

⁵⁷ As Barzel would suggest, standardization fails to take hold precisely because measurement costs associated with the particular term are prohibitive. Standardization is cost-effective only when an attribute can be cheaply measured or inferred. The complexity and contingency inherent in many precedent terms defy cheap measurement. Barzel, *supra* note 52.

⁵⁸ Choi & Triantis, *supra* note 20.

contractual dimension into an offsetting vector of economic value elsewhere. In markets where measurement is feasible, such trades occur. But where measurement breaks down, the conceptual unit of account needed for barter disappears. Parties may grasp that Term A is “worth something” without knowing how much, relative to Term B, in a way that permits systematic exchange.

Indeed, as we will describe in more detail, deal participants report that they do not experience negotiations as barter. Movement on one non-priced term does not compensate for movement on another; rather, each is its own arena of contestation, constrained by precedent and by the social norms governing what counts as a legitimate ask. In this sense, precedent terms behave nothing like currencies and everything like entitlements: each party seeks to hold the line on as many as possible, knowing that concessions are not offset by improvements elsewhere.

The barter story also sits uneasily with the widespread sense—expressed most loudly by lenders but shared off the record even by sponsor counsel—that terms have grown systematically more borrower-favorable. If parties were truly bartering along a constrained frontier, systematic drift in only one direction should be surprising. Yet that is precisely what we observe. The more plausible interpretation is that where price cannot absorb variation, power and precedent drive incremental change—and the gains or losses they produce are not neutralized elsewhere in the deal.

C. A Precedential Theory of Term Specification

Variable but unpriced terms present an obvious challenge. They create indeterminacy that the parties must somehow manage. What follows explains why precedent, rather than price or standardized form, often provides the structure needed to reach agreement.

The label we give to variable but unpriced terms gives away our central contention. We theorize that, in many contracting contexts, parties restrict the range of such terms’ indeterminacy by attributing normative weight to precedent. Negotiating parties anchor on the specifications that have been agreed in recent, similar transactions. They make the past presumptive. In this normative regime, parties argue—as common law lawyers do—about what a term ought to be in the present case. They can contest the definition of the body of precedents—the “comps”; they can emphasize similarities or draw

distinctions between the current deal and one or more precedent deals; they can contend that past deals are obsolete due to changed macroeconomic circumstances or otherwise. Failing to recognize the weight of precedent altogether, however, marks a party as acting in bad faith. That mark alone can be detrimental, as it may signal to prospective counterparties a willingness to violate expectations in the performance as well as the negotiation of a contract.

Parties must present countervailing reasons to justify deviation. And the burden of justification makes it harder, though of course not impossible, for a party in effect simply to appropriate greater surplus than the analogous party in similar deals received. Terms may in this way improve, albeit incrementally and uncertainly, over time, if change is predicated on counterparties acknowledging a commercial logic to the sought-after deviation. In the courts, precedent-based argumentation is justified as a highly imperfect way reach acceptable outcomes; so, in contracting, argument from analogy similarly may be the best-available means of groping toward efficiency.

But why should the recent past be a guide for the perplexed? More concretely, why would parties turn to market precedent for help specifying terms when they can't use standardization or price to divide the pie cleanly? Why not negotiate in an unconstrained fashion from first principles—principles of efficiency or fairness, say—or use coin-flipping or third-party *ex post* arbitration or majoritarian term adoption or some other mechanism?

To a certain kind of decision theorist, it's not much of a puzzle. For hundreds of years, at least, a strain of political and economic thought has argued for the wisdom of anchoring on the status quo. Especially under conditions of uncertainty and complexity, the thought goes, groups do better experimenting incrementally from their baseline than they do solving for an optimum through argumentation.

Best known in this tradition is Edmund Burke's plea for gradualism after the French Revolution.⁵⁹ Charles Lindblom's more recent defense of policymakers' observed habit of "muddling through" has a similar flavor.⁶⁰ If they are right, then negotiators who reason from precedent

⁵⁹ EDMUND BURKE, REFLECTIONS ON THE REVOLUTION IN FRANCE (1790).

⁶⁰ Charles E. Lindblom, *The Science of "Muddling Through,"* 19 PUB. ADMIN. REV. 79 (1959).

might simply be maximizing in an uncertain world.⁶¹ Put differently, a social practice in which market participants assign weight to recent deals might reflect what, in the economics literature, Vernon Smith calls “ecological rationality.”⁶² If computation is costly, the maximizing approach to term selection might emerge out of “home grown principles of action, norms, traditions, and ‘morality.’”⁶³

Some virtues of incrementalism are specific to contract negotiation among repeat players. For example, holding unpriced terms close to familiar values may help parties to assess the priced terms. Consider the problem the parties face when confront a mix of terms—all notionally significant and economically important—but only some of which have clear price signals. If the risk of non-linear interactions increases in the magnitude and number of changes to one set of terms, then varying their content widely may reduce parties’ ability to assess the price signals of *other* terms. By committing themselves in advance to reduce the degrees of freedom for nonprice term movement, parties can more quickly price and dispose of the remainder of the deal.⁶⁴

In a similar vein, the attribution of normative weight to precedent may give parties a rough-and-ready reference point that reduces negotiating costs and the risk of deal failure. Absent such a reference point, bargaining models describe equilibria where the party with the pen or the power, so to speak, anticipating that it won’t be “charged” for the specification it proposes, seek terms giving it maximum

⁶¹ See generally Matthew Jennejohn, *The Architecture of Contract Innovation*, 59 B.C. L. REV. 71 (2018) (providing an account of contract innovation that seems sympathetic with the idea of incremental experimentation).

⁶² Vernon L. Smith, *Constructivist and Ecological Rationality in Economics*, 93 AM. ECON. REV. 465, 470 (2003) (identifying the concept of “ecological rationality” whereby individuals make decisions based on “their experience and folk knowledge” as opposed to complex calculations or perfect information).

⁶³ *Id.*; see also Itzhak Gilboa and David Schmeidler, *Case-Based Decision Theory*, 110 Q.J. ECON. 605 (1995) (offering an extended challenge to standard rational choice theory on the ground that marginal adjustments can impose lower transaction and error costs than starting from scratch).

⁶⁴ For other accounts of the value of inertia, see Russell Korobkin, *Inertia and Preference in Contract Negotiation: The Psychological Power of Default Rules and Form Terms*, 51 VAND. L. REV. 1583, 1588–92 (1998) (experimental evidence); Carrie Menkel-Meadow, *Toward Another View of Legal Negotiation: The Structure of Problem Solving*, 31 UCLA L. REV. 754, 765 (1984) (utility of common business practice).

advantage.⁶⁵ Consider, for example, a term in a contract for the sale of goods that allows the buyer time to reject the goods after inspection. Suppose that, for whatever reason, the parties do not adjust price on account of the number of days specified. If the seller drafts, the contract will contain a value near or equal to zero days; if the buyer drafts, a much longer option would result.⁶⁶

The problem is that when the conditions underpinning precedent contracting hold, all parties appreciate at least roughly the significance of contestable terms. Non-drafting parties cannot, therefore, be expected simply to accept what the drafting party proposes. Costly pushback instead is the likely response, and negotiation may be especially expensive if each party must reason from first principles, to the other's satisfaction, about how a term ought to be specified. The implicit requirement that drafting parties at least start with what has been accepted in similar deals can thus be understood as a kind of bonding mechanism by which they promise not to seek to maximally advantageous terms. In other contexts, Yoram Barzel shows how sellers can use analogous proxies, such as brand, warranties, and reputation,

⁶⁵ Ken Ayotte and Patrick Bolton offer an instructive model that illustrates the dynamic in relation to so-called covenant-lite lending. Kenneth Ayotte & Patrick Bolton. *Covenant Lite Lending, Liquidity, and Standardization of Financial Contracts*, in RESEARCH HANDBOOK ON THE ECONOMICS OF PROPERTY LAW 174–89 (Kenneth Ayotte & Henry E. Smith eds. 2011). Traditional bank loans to corporate borrowers required the borrower to covenant that it would maintain specified financial ratios signaling ability to repay. In the 2000s, however, as the securitization of pools of such loans became an established business, maintenance covenants began to disappear. Ayotte and Bolton show that such a result is an equilibrium, even where maintenance covenants are fundamentally efficient, if it is costly for loan buyers to understand a covenant's significance and if other signals of a loan's value are sufficiently indicative. *Id.*; see also Ayotte & Scully, *supra* note 55. Loan buyers then will not undertake what Ayotte and Bolton call “reading costs” but instead will assume that the contract eschews valuable covenants and price the loan accordingly. Borrowers do best, under these circumstances, by promising (only) what the securitizers will pay for—by, that is, “water[ing] down the features of the contract that the loan buyers do not observe.” Ayotte & Bolton, *supra* note 59, at 188; cf. George A. Akerlof, *The Market for “Lemons”: Quality Uncertainty and the Market Mechanism*, 84 Q.J. ECON. 488 (1970).

⁶⁶ For evidence of pen holder effects in merger agreements, see Anderson & Manns, *supra* note 17, at 66 (2017) (“Generally, lawyers believe that the ability to create the first draft offers an advantage by giving lawyers the chance to choose the precedent and shape it to meet the needs of the new deal.”); Badawi & de Fontenay, *supra* note 27

to encourage buyers in the absence of precise estimates of quality.⁶⁷ Using the near past as a guide may in similar fashion ease the path to concluding deals.⁶⁸

One should be careful not to take the arguments for precedent as claims that precedent contracting is always efficient where it emerges. It may not be. (And whether it is may be unknowable.) Our claim is more modest: first, that commercial actors across a wide range of contracting environments might reasonably think incrementalism a sensible approach; and, second, that a social practice in which past deal terms bear normative weight can reasonably be understood as an institutional adaptation the function of which is to economize on measurement costs (specifically, the costs associated with accurately quantifying the incremental value of certain non-price terms).

In any case, our picture of negotiation is consistent with a substantial literature observing that, as a matter of fact, precedent plays an important role in many contracting contexts. The production of M&A contracts, in particular, has received the widest and deepest attention, and researchers universally find that a new contract's negotiation starts where previous, similar deals concluded.⁶⁹ The research reveals, among other things, that lawyers spend a great deal of time and money learning about other deals,⁷⁰ including through

⁶⁷ Barzel, *supra* note 52.

⁶⁸ See also Mark C. Suchman, *Translation Costs: A Comment on Sociology and Economics*, 74 OR. L. REV. 257, 264 (1995); see also Lisa Bernstein, *The Silicon Valley Lawyer as Transaction Cost Engineer*, 74 OR. L. REV. 239, 250 (1995) (describing value).

⁶⁹ See, e.g., John C Coates IV, *M&A Contracts: Purposes, Types, Regulation, and Patterns of Practice*, 7 (Eur. Corp. Governance Inst. Law Working Paper No. 292/2015), <https://ssrn.com/abstract=2593866>; Cathy Hwang, *Unbundled Bargains: Multi-Agreement Dealmaking in Complex Mergers and Acquisitions*, 164 U. PA. L. REV. 1403, 1435 (2016); Stephen J. Choi, Mitu Gulati, Matthew Jennejohn & Robert E. Scott, *Contract Production in M&A Markets*, 171 U. PA. L. REV. 1881 (2023).

⁷⁰ David J. Parnell, *David Perla Of Bloomberg Law, On Technology, Artificial Intelligence, And Liberalization In BigLaw*, FORBES (June 2, 2015, 3:14 PM), <https://www.forbes.com/sites/davidparnell/2015/06/02/david-perla-bloomberg-on-technology-artificial-intelligence-liberalization/>.

informal inquiries⁷¹ and networks of counsel,⁷² and that common terms change over time and in response to shocks.⁷³

Precedent contracts can be used merely as a source of boilerplate terms to be replicated. Sovereign bond underwriters seem to use precedent for that limited purpose.⁷⁴ But the M&A literature conceives of precedent as a normative basis for discussion along the lines we are outlining.⁷⁵ This is also the conclusion that Bengtsson and Bernhardt make after studying the wide range of “cash flow contingency” terms in the venture capital world. As they find, though terms aren’t standardized, each individual VC specializes in consistent suite of terms.⁷⁶

To the extent that observers have grappled with precedent’s use, however, they have tended to eschew functional explanations and instead put intermediaries, especially lawyers, at the center of the stage. It’s the *lawyers* who like arguing about precedent. Elisabeth de Fontenay, in her influential work on law firm selection, argues that in certain contracting environments—where parties agree to price before negotiating most non-price terms—lawyers can be valuable precisely because, and to the extent that, they are familiar with the non-price terms on which a deal is likely ultimately to be struck and can therefore help clients understand the “relative payoffs and pricing of transaction

⁷¹ Kenneth A. Adams, Shwang Cheadle, Christopher Koa, Florence Pinigis, *Contract Drafting to Avoid Disputes and Inefficiency*, *Association of Corporate Counsel*, at https://www.acc.com/sites/default/files/resources/vl/membersonly/ProgramMaterial/1239661_1.pdf

⁷² See generally Stephen J. Choi, Mitu Gulati, Matthew Jennejohn & Robert E. Scott, *Contract Production in M&A Markets*, 171 U. PA. L. REV. 1881 (2023) (discussing how networks of M&A lawyers lead to the proliferation of contract terms.)

⁷³ John C Coates IV, *M&A Contracts: Purposes, Types, Regulation, and Patterns of Practice*, 7 (Eur. Corp. Governance Inst. Law Working Paper No. 292/2015), <https://ssrn.com/abstract=2593866>.

⁷⁴ MITU GULATI AND ROBERT E. SCOTT, *THE THREE AND A HALF MINUTE TRANSACTION: BOILERPLATE AND THE LIMITS OF CONTRACT DESIGN* (2012).

⁷⁵ See especially Hwang, *supra* note 54; Jennejohn, *supra* note 61.

⁷⁶ Ola Bengtsson & Dan Bernhardt, *Different Problem, Same Solution: Contract-Specialization in Venture Capital*, 23 J. ECON. & MGMT. STRATEGY 396 (2014).

terms.”⁷⁷ At the same time, market arguments have the additional advantage of permitting their makers to signal that they are informed participants in the relevant community.⁷⁸ These ideas suggest that lawyers may benefit most from a mode of bargaining in which knowledge of precedents and skill in analogical argumentation are prized.⁷⁹

We don’t reject the possibility that agency problems between lawyer and principal help to explain the extent of market contracting in some environments—not as a matter of fact and certainly not on theoretical grounds.⁸⁰ But agency-cost accounts are inherently limited. They can’t explain why precedent is used to negotiate some but not other terms. They can’t easily explain change, or drift, in the parameters within which one or another term is negotiated. And they can’t explain precedent-based negotiation in environments in which principals themselves have a strong grasp of the comps and the significance of individual terms.

Seen this way, precedent contracting is not a quirky feature of leveraged loans or M&A. We suggest instead that it is a mode of private ordering used widely when the price mechanism runs out. In that environment, “bargaining” no longer approximates Coasean trade in marginal entitlements. It looks more like common-law reasoning: parties argue from analogy, contest the relevance of prior cases, and push for incremental moves within a shared normative frame. The familiar phenomenon of indignation at a counterparty’s aggressive asks—their failing to acknowledge what’s “market”—and appeals to professional consistency are not noise around a price-driven core. They

⁷⁷ Elisabeth de Fontenay, *Market Information and the Elite Law Firm*, 8 (Duke L. Sch. Pub. L. & Legal Theory Series No. 2017-32, 2017), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2947104; de Fontenay, *supra* note 11, at 396. This will also reduce the likelihood that the deal will fall apart. Cf. De Fontenay, *Market Information*, at 7.

⁷⁸ Claire A. Hill, *Repetition, Ritual, and Reputation: How Do Market Participants Deal with (Some Types of) Incomplete Information?*, 2020 WIS. L. REV. 515 (2020). Conversely, not knowing what’s market leads to reputational penalties. Jonathan M. Barnett, *Certification Drag: The Opinion Puzzle and Other Transactional Curiosities*, 33 J. CORP. L. 95, 129 (2007).

⁷⁹ De Fontenay, *supra* note 5, at 421–23; *accord* Coates, *supra* note 7.

⁸⁰ A different agency story, suggested to us by Jon Klick, is that parties know that they do not have a ready way to estimate agency shirking or looting when dealing with nonprice terms, and use precedent to cabin the agent’s degrees of freedom.

are the central technology for allocating unpriced surplus. Our account, in that sense, is a reorientation of bargaining theory for private law: it explains how parties discipline one another when they cannot discipline terms through price. Sophisticated contracting relies on a second system of bargaining, both precedential and normative, that coexists with but is distinct from price-mediated negotiation.

We offer a functional rationale for the normativity—and contestability—of precedent that predicts, at least heuristically, the conditions under which it will emerge as well as its limits. What our theory doesn't yet provide is any predictions about the actual content of what's market. Factors like time (how long back does market go), size (how many deals), type (what match is necessary) and value (does deal size matter) should be inputs into precedent selection, just as jurisdiction, time, facts and judge matter for litigators.⁸¹ Surely, "what's market" has different meanings in different communities of practice, since what's being asked is really "what kind of arguments are recognized as legitimate" in a world where there are few objective ways to evaluate the claim.

III. PRECEDENT TERMS IN LEVERAGED LOAN ORIGINATION

Part II leaves open a lot of questions. If precedent terms describe a conceptually identifiable subset of contract terms, how big is the set? What fraction of terms fit the description? How economically significant are they? How do parties in fact sort out what value a precedent term will take on in any particular contract? What follows is not a case study for its own sake. We intend to test whether the domain described above is large and organized enough to structure contracting in an actual, high-stakes market. If the account is wrong, leveraged loans should reveal a priced margin masquerading as something else. If it is right, they will show a negotiated but unpriced terrain that standard models do not register.

Answers to these questions should depend on the contracting environment. This Part describes our exploration of the place that precedent terms have in the origination of leveraged loans. Through conversations with participants on all sides of origination, we can get

⁸¹ Cf. Yun-chien Chang & Geoffrey Miller, *Decay of Precedents in State Supreme Courts*, 26 J. LEG. PUB. POL'Y 309, 313-17 (2024) (summarizing literature on the decay of precedent in litigation and scholarship).

purchase in an important commercial context. Broadly speaking, we find that precedent terms play an important role in the contracting process. Up to perhaps 100 unique variables may fit the description, and knowing the prevailing norms and being able to advocate for their application seem to be a big part of the *contractual* part of origination and syndication for the parties and especially their lawyers.

A. *The Leveraged Loan Market*

In the argot of corporate finance, “leveraged loan” not only describes a distinctive class of credit product but also conjures a distinctive institutional arrangement that produces and consumes the product. We use the phrase to refer to a term loan made by an arranger (typically a bank) to a below-investment grade company, at a floating rate, secured by substantially all of the borrower’s assets, that is designed to be syndicated in small pieces to numerous non-bank institutional investors.⁸² Loans originated in this so-called “broadly syndicated” market vary widely in size, ranging from perhaps \$250 million on the small end to the single-digit billions of dollars on the large end.⁸³ In the aggregate, nearly \$2 trillion principal amount of such loans are outstanding,⁸⁴ and they trade in a relatively liquid, dealer-mediated secondary market.⁸⁵ In many respects, leveraged loans resemble high-yield bonds as much as the traditional bank loans from which they evolved.⁸⁶

⁸² These loans are sometimes called “institutional loans” or “term loan B.” In some usages, the term leveraged loan stands for a broader category that subsumes institutional as well as bank-held loans. Nothing important hinges on terminology. We are concerned with *first-lien* loans only. There is a second-lien variant that some would call a leveraged loan. But second-lien loans tend to be much smaller in size and syndicated to different types of buyers who form more concentrated syndicates. The differences in market structure are significant enough that we ignore second-lien loans in this paper.

⁸³ Greg Nini & David C. Smith, *Leveraged Finance*, in *Handbook of Corporate Finance* 249–93 (David J. Denis ed. 2024).

⁸⁴ Deborah J. Enea and Beckie Schatschneider, *SEC’s Leveraged Loan Market*, THE TEMPLE 10-Q, <https://www2.law.temple.edu/10q/secs-leveraged-loan-market>.

⁸⁵ Nini & Smith, *supra* note 83, at *38–39.

⁸⁶ See *Kirschner v. JP Morgan Chase Bank, N.A.*, 79 F.4th 290 (2d Cir. 2023) (holding that leveraged loans, despite their similarity in some respects to bonds, are not securities within the meaning of federal securities acts). For further

The distinctive features of leveraged loans and their supporting institutions emerged during the early 2000s, when innovators realized that risky corporate debt, like so many other hazards, could be profitably securitized. A new class of structured vehicle, the collateralized loan obligation (CLO), emerged to pool and tranche risky corporate loans. The market grew rapidly during the 2010s, after Dodd-Frank-inspired regulation encouraged banks to move loan risk off their balance sheets, ultimately reaching a rough parity with the high-yield bond market.

Three types of entity are party to a leveraged loan deal in the primary market:

Borrower. The companies that borrow via leveraged loans operate across all industries in which cash flows are predictable enough to support a lot of debt. A majority are owned by a private equity sponsor or club of sponsors. This is so in part because sponsors often tap the leveraged loan market to finance acquisitions (whether in a take-private LBO or in a private-private purchase from a family or other sponsor). Practically, then, a sponsor often helps to negotiate the terms that the borrower will agree to.⁸⁷ Public companies also issue leveraged loans, however, including some of the largest such loans.⁸⁸ The place they occupy in borrower capital structures varies likewise. A leveraged loan is always the senior-most term debt. But it can account for all of the borrower's funded debt or just a piece—the tip or the sum and substance of the debt iceberg.

Arranging Bank (or lender). The bank that arranges a leveraged loan plays a role like that of an underwriter in a securities issuance. Its function is to intermediate borrowers who want capital and dispersed investors who want to provide it. It thus interfaces with both sides of

discussion, *see, e.g.*, Cathy Hwang, Yaron Nili & Jeremy McClane, *The Lost Promise of Private Ordering*, 109 CORNELL L. REV. 1 (2023); Frederick Tung, *Do Lenders Still Monitor? Leveraged Lending and the Search for Covenants*, 47 J. CORP. L. 153 (2021); Mitchell Berlin, Greg Nini & Edison G. Yu, *Concentration of Control Rights in Leveraged Loan Syndicates*, 137 J. FIN. ECON. 249 (2020); Bo Becker & Victoria Ivashina, *Covenant-Light Contracts and Creditor Coordination* (2016) (working paper).

⁸⁷ In the context of a LBO, the sponsor whose fund will acquire the target is quite clearly the party negotiating the borrower's side. Sponsors frequently continue post-acquisition to assist portfolio companies in their negotiation of capital market transactions.

⁸⁸ Nini & Smith, *supra* note 83, at *40.

the market simultaneously. On one hand, the bank is negotiating terms with the borrower with a view toward ultimately inking the loan agreement and funding the loan. On the other hand, the bank is marketing pieces of the loan to potential investors, building a book so that it can sell its (sometimes very large) exposure immediately after closing. Large money-center banks such as JP Morgan Chase, Bank of America, and Citibank have the lion's share of the business.

Investors (or loan buyers). For the most part, the buyers of leveraged loans are non-bank institutions that specialize in holding and managing portfolios of corporate loans. Approximately 70 percent of leveraged loans are syndicated to CLOs, which finance their loan portfolios with a mixture of AAA-rated and riskier notes. The managers who make investment decisions on behalf of CLOs take an equity stake in the vehicle, giving them high-powered incentives to seek risk-adjusted returns but also to construct portfolios that are riskier than investors might like.⁸⁹ Consequently, CLO governing documents limit risk taking in various ways, including by requiring that the CLO hold loans that one or more rating agencies have rated and specifying penalties that the manager will suffer if the portfolio includes too many especially low-rated loans.⁹⁰

An origination process starts with a borrower approaching one or more banks to rough out key financial terms. (Private equity sponsors looking for acquisition financing—and their portfolio companies—often solicit bids from multiple banks simultaneously. To streamline communication, they frequently do so with the help of a construct known as “designated counsel.” The sponsor will condition a bank's eligibility to vie for the deal on its willingness to be represented by the same counsel (of the sponsor's choosing) as represents all of the other bidding banks.)

The identity of the first mover varies. When the borrower is a corporate institution that rarely taps the leveraged capital markets, the bank will often take a first pass at setting out terms. When the borrower is a sponsor or sponsor-owned portfolio company, the sponsor will take the first pass.

⁸⁹ See, e.g., Larry Cordell, Michael R. Roberts & Michael Schwert, *CLO Performance*, 78 J. FIN. 1235 (2023).

⁹⁰ See, e.g., Shohini Kundu, *Covenant-Driven Fire Sales* (September 17, 2021), <https://ssrn.com/abstract=3735645>; Redouane Elkamhi & Yoshio Nozawa, *Fire-Sale Risk in the Leveraged Loan Market*, 146 J. FIN. ECON. 1120 (2022).

The operative work product is an elaborate term sheet known as the “grid.” The grid sets out perhaps a hundred variables ranging in economic importance from the interest rate that the borrower will pay (expressed as a spread over the benchmark rate, formerly LIBOR now SOFR) to the nature of other obligations the borrower can have, to what happens in future contingent states of the world, and specifies the template contract that the parties will otherwise base their agreement on.

The bank’s and borrower’s counsel will go back and forth proposing adoption of this or that term.

At some point, the borrower and bank will settle on a deal. A commitment letter from the bank memorializes the terms on which it agrees to lend. Key to the commitment letter is a concept called “flex.” Many terms to which the bank agrees have two values. One is the value at which the bank commits to trying to market the loan. For example, the bank might commit to *trying* to lend at a spread of 300 basis points over SOFR. The flex value is the value at which the bank commits to fund. For example, the commitment letter could allow the bank to flex the spread by 50 basis points, i.e. ultimately to lend at S+350, if during marketing the bank determines that investors lack appetite for a loan with the more borrower-friendly terms.

At various stages of concreteness, the bank is feeling out investor demand. The investors never negotiate directly with the borrower and do not want to be understood to be negotiating at all, lest an aggressive tax authority construe the investor to be engaged in the trade or business of lending.⁹¹ But the CLO managers give comments to the bank. In an early phase of marketing, the manager may simply register its generic interest (price/size) in an allocation. Demand for an allocation as well as “comments” inform the bank as to whether it will need to flex terms, which terms to flex, and by how much. The bank will engage rating agencies to rate the loan, since it is understood that ratings constrain most of the potential buyers. By the time the bank and borrower have settled on the final terms, potential investors may have only two days or so to decide whether to commit to take a piece of the loan in syndication. As a matter of contractual right, investors can typically back out until after the loan closes. Doing so is a *faux pas*,

⁹¹ See, e.g., YA Global Investments, LP v. Commissioner, 161 T.C. No. 11 (Tax Ct. 2023) (finding that a convertible bond fund was engaged in a trade or business).

however, and would justify a bank excluding the investor who exercised its contractual right from future syndications.

B. Interviews

To get color on the phenomenology of contract negotiation and assess how deeply loan buyers price differentiate contracts, we talked via Zoom with lawyers representing all sides of the primary market as well as with investors and employees of a rating agency. Twenty professionals who specialize in the leveraged loan market spoke with us for between 30 minutes and an hour each. They include a handful each of borrower counsel, bank counsel, and loan investors, plus intermediaries whose business is to interface with market participants. We promised anonymity to inspire candor in a world in which not all the interviewees' clients and partners might appreciate seeing it in print.

The conversations were loosely structured to allow interviewees to tell us what they thought important to our general topic of interest, namely the selection of non-price terms in a leveraged loan origination. We did, of course, want to learn whether the “precedent term” construct could be valuable to an account of origination and, if so, which of the hundreds of terms in a loan contract it could describe. But we took pains not to confront interviewees with our thesis, so to speak, in a way that might bias response. After asking an interviewee to talk in open-ended fashion about his or her experience of term selection generically, we typically asked about concrete provisions. We might ask how a specific variable—the amount of a restricted payments basket provisions, say—gets determined or, to an investor, whether such a variable has a place in his firm's pricing models or investment committee deliberations. To the extent we asked explicitly about the plausibility of our taxonomy, and we did ask several interviewees, we did so only near the end of a conversation or when an interviewee seemed to light on a similar framework spontaneously.⁹²

⁹² We sent a copy of this paper to the interview subjects and asked them both to confirm that we had quoted them accurately and in a contextually appropriate manner and to offer additional comments if warranted. We identify comments that were offered as follow-up as “Correspondence with ____”.

C. Findings

1. *The Domain of Precedential Contracting.*

The interviewees broadly agree on the topics we discussed. They concurred almost universally on the mechanics and general characterization of the loan origination process. As we expected, they believed that many important terms in a typical leveraged loan deal have the characteristics of what we call precedent terms.

A starting point on which every interviewee agreed is that much—depending on how one counts *most*—of each leveraged loan agreement is boilerplate.⁹³ By this they mean not necessarily that every contract has identical language. There are multiple templates, or “forms,” in use in the market at any moment. Each private equity sponsor, for example, or lawyer who specializes in representing sponsors, may have a unique form.⁹⁴ And the forms differ not only in the way that one or another provision with substantially the same content is phrased, but also sometimes in content.

In that sense, it is not quite right to say that all leveraged loans are identical with respect to boilerplate provisions. Boilerplate refers more narrowly to terms any variation in which is viewed as inconsequential and which, therefore, no one discusses or thinks of altering the language that the proponent suggests. Instead, the “grid” that a proponent, usually the sponsor if there is one, circulates to prospective counterparties simply identifies by name a precedent contract embodying the proponent’s preferred form and declares that the precedent terms will supply all contract terms other than the terms identified as being up for grabs.⁹⁵

Approximately 100 terms are negotiated.⁹⁶ The grid identifies the variables that the proponent (usually the borrower) thinks its potential counterparty (usually multiple banks) will care about and proposes a value for each. There is little mystery in the items a grid will address.

⁹³ Interview with Loan Investor 3 (“You’re not gonna have time to really think about the document, and the lawyers love [boilerplate] right.”).

⁹⁴ Interview with Lender Counsel 2.

⁹⁵ This is called “documentation precedent.” Interview with Borrower’s Counsel 2.

⁹⁶ Interview with Lender Counsel 4 (“It depends so for some sponsors. Yes, that’s true. If they’re represented by like Kirkland, they’ll send a hundred page or a hundred row grid.”)

The same terms are negotiated in each deal, irrespective of the form that is used to document the transaction. As one lender’s counsel put it, everyone in the market “speaks the same language.”⁹⁷

To no one’s surprise, core financial terms are in the grid: the loan amount and tenor, the spread the borrower will pay, and so on. And it’s reasonably clear why at least some secondary and tertiary provisions would resist standardization. The large size of leveraged loan syndicates is one reason. Perhaps 200 funds may own pieces of a typical deal.⁹⁸ That makes renegotiation difficult, which, in turn, increases the value of tailoring initial terms. Heterogeneity across multiple dimensions of leveraged loan deals, at any given moment and especially across time, means that lots of potential value would be sacrificed if a single form set financial and operational slack for all loans. Borrowers operating in industries with different volatility profiles and growth opportunities. Some operate domestically while others are transnational (and thus may warrant greater flexibility to take advantage of tax and other policy variation). Management teams may differ in ways that predictably affect a borrower’s solicitude toward lenders.⁹⁹ Changing expectations about future interest rates affect tradeoffs across the board.¹⁰⁰ In short, borrowers vary at a given time and as a group across time, in the severity of the adverse selection and moral hazard risks they pose.¹⁰¹ It follows that a one-size-fits-all-and-for-all-time approach to defining covenant thresholds would surrender potentially considerable joint surplus if parties are even roughly able to distinguish high- from low-risk borrowers.¹⁰²

⁹⁷ Interview with Borrower’s Counsel 2 (“Everybody speaking the same language. The grid depending on the type of financing, could be 60 rows. It could be 120 rows and the advisors we work opposite of the arrangers that we work with. They all know what every single line item means . . . You know the 2 or 3 or 5 things that are specific to this type of financing. That we want to negotiate.”).

⁹⁸ Mitchell Berlin, Greg Nini & Edison G. Yu, *Concentration of Control Rights in Leveraged Loan Syndicates*, 137 J. FIN. ECON. 249 (2020).

⁹⁹ Vincent S.J. Buccola, *Sponsor Control: A New Paradigm for Corporate Reorganization*, 90 U. CHI. L. REV. 1 (2023).

¹⁰⁰ Choi & Triantis, *supra* note 20, at XX.

¹⁰¹ *Id.*

¹⁰² *Id.*

Interviewees did not offer an abstract criterion for sorting negotiated from boilerplate terms. Convention seems to answer the question for practical purposes. We thus hesitate to offer an explanatory theory. Nevertheless, it seems to be the case that scalar variables affecting borrowers' financial slack are especially likely to be negotiated. Limits on the borrower's ability to incur additional debt, to pay dividends, and to release security interests, for example, are specified through a variety of interacting terms each of which can vary deal-to-deal. These terms embody tradeoffs the parameters of which are very likely to vary across borrowers and over time. Thus, although we hesitate to oversimplify, practice appears to correspond reasonably well to theory, in the sense that parties negotiate terms the costs of standardization of which would be high.¹⁰³ One lender's lawyer would, with Coates,¹⁰⁴ attribute the negotiation of at least some provisions to agency costs.¹⁰⁵ In his view, counsel, especially borrowers' counsel, benefit on the margin by appearing busy and touting "wins" to their clients, who would do just as well with a more standardized loan contract.¹⁰⁶

Most interviewees believe that few of the negotiated terms bear on the yield that investors receive if they buy a loan. The most important financial and risk terms certainly are priced. Interviewees did not hesitate to conclude that a loan's tenor¹⁰⁷ and anticipated rating,¹⁰⁸ the borrower's leverage (or first-lien leverage),¹⁰⁹ and, interestingly, the reputation of the borrower's financial sponsor¹¹⁰ (where relevant) would affect yield in predictable ways.

¹⁰³ Cf. Robert Bartlett, *Standardization and Innovation in Venture Capital Contracting: Evidence from Startup Company Charters* (Stan. L. & Econ. Olin Working Paper, Paper No. 585, 2023). Our findings are consistent with his.

¹⁰⁴ See Coates, *supra* note 7.

¹⁰⁵ Correspondence with Lender's Counsel 3.

¹⁰⁶ *Id.*

¹⁰⁷ Interview with Loan Investor 3.

¹⁰⁸ Interview with Lender's Counsel 4.

¹⁰⁹ Interview with Loan Investor 3; Interview with Lender's Counsel 4.

¹¹⁰ Interview with Borrower's Counsel 4; Interview with Lender's Counsel 4; Interview with Loan Investor 1.

Variation in the terms that interviewees believe are priced is apt to have a large effect on a loan's expected value and to be reasonably tractable. Consider loan tenor, for example. The maturation of a loan gives lender, in effect, an option to call or reprice their capital investments. A 5-year loan is thus more attractive to lenders than a 7-year loan is, all else equal. Investors can use reasonably simple option pricing models to calculate the difference in value in light of their own expectations of interest-rate and cash-flow volatility (both of which investors form views on as part of the basic business of underwriting). One investor explained that tenor is easy to incorporate into pricing models because it "becomes more mathematical."¹¹¹

We did not seek to catalog each interviewee's beliefs about which negotiated terms are priced. But all seemed to think that a marginal change in very few of the negotiated terms would result in a marginal change in yield.

One example of a negotiated term that market participants seem to care about but believe is unpriced is the delta on an incremental borrowing provision's most favored nation (MFN) clause.¹¹² An incremental borrowing provision (sometimes called an "accordion") refers to a ubiquitous feature of leveraged loan agreements that allows the borrower to increase the amount of first-lien loans it has outstanding after the initial loan is funded—that is, to expand like an accordion the amount of debt that will share in proceeds of the first lien should things go wrong.¹¹³

An MFN clause adds a proviso to an accordion. The borrower can incur incremental debt only if the interest it will pay on the new debt is no greater than what it pays on the contract debt *plus* some delta.¹¹⁴ If the initial loan pays, say, 350 basis points over the benchmark rate (S + 350) and the delta is 25 basis points, then the borrower can offer no more than S + 375 on an incremental loan without topping up the initial lenders. The bigger the delta, therefore, the more freedom a borrower

¹¹¹ Interview with Loan Investor 3.

¹¹² E.g., Interview with Borrower's Counsel 4 (part of a holistic analysis of a credit); Interview with Lender's Counsel 3 (could be part of an "aggressive" document but probably not directly priced).

¹¹³ MICHAEL BELLUCCI & JEROME MCCLUSKEY, *THE LSTA'S COMPLETE CREDIT AGREEMENT GUIDE* 38-41 (2d ed. 2017).

¹¹⁴ *Id.* at 39.

has practically to issue dilutive debt. Moreover, because the interest rate a new lender will demand tends to increase as the borrower's financial condition deteriorates, a large delta may allow the borrower to dilute the initial lenders just when they will worry most about the effects of dilution on their likely recoveries.

That the size of the MFN delta bears to some extent on the distribution of possible recoveries that initial lenders face is plain to see. Beyond that little is clear. The optimal size of an MFN delta for a given loan is certainly hard to know. It will depend on borrower-specific facts that may be hard for lenders to verify as well as macro factors such as likely change in interest rates (and so spread tightening or widening). Just a few of the borrower-specific considerations would include the likely size of the lending syndicate (and thus the costs of renegotiation), the likelihood that the borrower will have prudent investment opportunities while the contracting loans are outstanding, and the likelihood that the borrower will face distress (and thus a temptation to kick the can rather than restructure).

Focusing more narrowly on lenders' interests hardly simplifies things. The question is how to assess the likely effect on a loan's ultimate recovery of, say, a marginal 25 basis points of MFN delta. Logic says there must be some effect. But how much? First principles are of little help. Gaming out and assigning weights to all of the possible futures in which a MFN clause might (or might not) matter is impractical. Nor will historical data offer a ready estimate. The expected effect size, so to speak, of an increase in the delta should be negative but small, and there are a thousand confounds.

Investors care about the MFN delta even if it hard to value. As one lender's counsel puts it, the MFN is "one of the top points that all of the buy side focus on."¹¹⁵ One could easily imagine that market participants, faced with the difficulty of sorting out the significance of variation in MFN deltas, would opt to standardize its magnitude. But that is not what has happened. Instead, deltas and other interacting provisions, such as the MFN's duration (if there is a sunset), vary across deals. A 50-basis point delta is common, but 75- and 100-point deltas are, too. One borrower's counsel remarks that MFN terms seem to be highly sensitive to market conditions, with durations shortening

¹¹⁵ Interview with Lender's Counsel 3; *accord* Interview with Lender's Counsel 4 (describing the MFN as one of the terms that "everybody is focused on").

and deltas “blow[ing] out” in hot markets and contracting in tight markets.¹¹⁶

The challenge from orthodox optimal contract theorists is to explain why a term that investors care about would not affect their bid for a loan. The answer seems to be that assessing the expected fundamental value (cost) of most terms is too complex a task to be done given the relatively small stakes that any individual term poses. A kind of satisficing is therefore the dominant approach. One borrower’s counsel described investors as satisficing in relation to the universe of comparable loans. “[T]he way they look at it,” he says, “is ‘what’s this credit?’ Then they look at the price. And on the covenant side it’s more about ‘are the covenants consist[ent]with other covenants?’”¹¹⁷

The investors we spoke with—who, to be clear, are sharps—are clear that they do not seek to model the cost of each negotiated term.¹¹⁸ Their valuation work focuses on the robustness of the borrower’s business and the amount of debt its cash flows will have to service. Not many terms from the contract have a place in quantitative pricing models.¹¹⁹ This is not for a lack of understanding that the borrower’s operational and financial flexibility can affect a loan’s fundamental value.¹²⁰ They are keenly aware of state-of-the-art issues in covenants and related terms. Nor is it for lack of financial or empirical sophistication. We talked to individuals who have at their disposal empirically trained brains of the caliber of most finance departments (since they pay those brains’ bodies more than any business school could).

One experienced loan investor, the Chief Investment Officer at a major CLO manager whose background is “in applied math,” explains that he has overseen efforts to work out a method for rigorously assessing the import of non-price contract variables.¹²¹ The most promising approach he has identified would produce a contractual

¹¹⁶ Interview with Borrower’s Counsel 3.

¹¹⁷ Interview with Borrower’s Counsel 1.

¹¹⁸ Interview with Loan Investor 1 (don’t have the information to “fine tune”); Interview with Loan Investor 3; Interview with Loan Investor 4.

¹¹⁹ Interview with Loan Investor 4; Interview with Loan Investor 3.

¹²⁰ Interview with Loan Investor 4.

¹²¹ Interview with Loan Investor 4.

flexibility metric or suite of metrics to, in effect, average over many contract variables. He could then determine how much of historical loan performance this metric could explain that his current pricing models could not. But efforts so far have been fruitless. Interactions among loan terms are too complex. Some variables matter not at all unless some other variable takes on a particular value in a particular context but then can matter enormously. Investors exclude terms from valuation models because modeling them is too hard.

Nor do market intermediaries seem to have solved a computational task that individual investors lack scale to achieve. The credit rating agencies are an obvious candidates to have done so. CLO governing documents require a rating for the bulk of assets that the manager will hold.¹²² Two and sometimes three agencies therefore rate every leveraged loan, at the loan and issuer level. They gather information about the borrower and proposed loan terms before closing, and they follow loan performance over time. At first approximation, then, the agencies have all of the relevant data. A B-rated loan has a higher yield than a B+-rated loan, so one could suppose that terms impacting moral hazard are priced indirectly through the rating mechanic rather than directly by CLO managers. It seems, however, that this is a theoretic more than a realistic possibility. Rating agency employees say that ratings are insensitive to most contract variables.¹²³ The rating process focuses on the borrower's financials, capital structure, and pro forma leverage characteristics.¹²⁴ The contract matters only to the extent that it (partly) determines the borrower's capital structure and interest costs.¹²⁵

Other intermediaries could do what the rating agencies do not. Several services, the most prominent of which is Covenant Review, hire finance lawyers to read each loan contract as it comes to market and synthesize the financially relevant information for investor clients. These services thus see a huge fraction of all leveraged loans, much as the rating agencies do, and license their insights to investors. Covenant

¹²² Interview with Loan Investor 1 (opining that CLOs are “judged on rating”).

¹²³ Interview with Rating Agency 1, Rating Agency 2, Rating Agency 3.

¹²⁴ *Id.*

¹²⁵ *Id.* The inference to be drawn is that the rating agencies' function is narrowly to ameliorate investment managers' risk-taking incentives. Solving their data or computational problems is not on the agenda.

Review even produces an aggregate covenant “score”—a number on a 1-to-5 scale—that is meant to represent the contract’s favorability to investors. “Everyone uses Covenant Review,” says one investor.¹²⁶ Its analysts will flag extraordinary terms in a marketed deal and can help investors sort through legalese to calculate amounts that may “leak” from the borrower.¹²⁷ But its and similar products do not seem to help investors price differentiate loans according to covenant quality. Scoring is too blunt for that purpose because it is univariate while the economics of covenants are multivariate and complex (in the sense that terms interact with one another and with future states of the world).¹²⁸

Without price signals, we anticipated that participants have to find other ways to cabin their own choices, consistent with the theory we sketched above. And, unsurprisingly, they turned to precedent.

2. *The Role of Precedent in the Leveraged Loan Market.*

It was our hypothesis that precedent, in the form of prior deals, channels negotiations about non-price terms in this market. And our interview subjects confirmed that view. Unlike in litigation, precedent here doesn’t have a jurisdictional and legal basis but rather a normative, temporal and economic one.

“What is market” has normative force.¹²⁹ If a proposal departs from “the precedent” you will need to find ways to “bring it back to something which is more reasonable and more in line.”¹³⁰ Moments when “we’re trying to create, like, an outlier,” a Borrower’s counsel said, demand special justification of *this is* what’s important for this deal.”¹³¹ Market participants universally affirmed that it would be odd to be the first to push a new term, that is, unless you are a “sophisticated

¹²⁶ Interview with Loan Investor 3.

¹²⁷ *Id.*

¹²⁸ Interview with Loan Investor 4.

¹²⁹ Interview with Entrepreneur 1 (“[I]f you’re able to show, if you’re able to quantify to a firm that in a certain number of deals they’ve accepted specific types of terms in the past, then it will be more difficult for them to reject those terms in future deals. So there is a precedential reliance based on professional consistency.”)

¹³⁰ Interview with Lender Counsel 3.

¹³¹ Interview with Borrower’s Counsel 1.

player” with significant power. Sponsors with power can “hold the line” on their terms and “impose it on everybody.”¹³²

But generally precedent acts as an anchor—both parties worry that if they push back too hard against recent practice they’ll lose the deal¹³³—and a way to use leverage in socially acceptable ways.¹³⁴ It also sets the terms of the negotiation: are you “demanding the middle of the fairway” or “most borrower-favorable, cutting-edge terms? That’s unspoken and understood in the context of a sponsor deal.”¹³⁵ Precedent “sets the boundaries of . . . what a reasonable negotiation is.”¹³⁶ This feature of precedent may help price discovery. One interviewee speculates that terms being *similar enough* from deal to deal gives loan buyers confidence in their pricing models.¹³⁷ Whether or not such a functional account supplies the deep explanation for precedent’s force, on the ground precedent matters in part because counsel—like bankers and investment managers—feel pressure to have “professional consistency”:

[If] you can show somebody that in the last 80% of their deals they have accepted some term in some context, they will be hard pressed not to accept it in this context, because they’ll have to explain to the client why their deal is different than whatever deal they’ve accepted in the past.¹³⁸

The idea that sponsors/borrowers use precedent to impose their will came up repeatedly. Sponsors are “controlling the market and

¹³² Interview with Borrower’s Counsel 3. That lawyer contrasted powerful firms and sponsors with unsophisticated counsel, reflecting on a client who came in with bad terms: “They hired some local firm, and they just got kind of hosed.”

¹³³ Interview with Borrower’s Counsel 1 (“Well, what are the banks really concerned about? The banks are really concerned about getting the terms right enough so they can sell them . . . They’re concerned about what moves in the market.”).

¹³⁴ “So the way covenants get moved are in the great deals, and then you have the next sponsor comes next week with a different deal. Maybe it’s not so great who knows about the asset. But, oh, you just gave me all these terms in that deal. This is now my precedent. This is what I have. So that’s the way the market gets moved.” Interview with Lender’s Counsel 5.

¹³⁵ Interview with Borrower’s Counsel 3.

¹³⁶ *Id.*

¹³⁷ Correspondence with Lender’s Counsel 3.

¹³⁸ Interview with Entrepreneur 1.

controlling the deal flow not just for the lawyers, but also for the banks.’”¹³⁹ They do so in hot markets, where demand for their product is higher: it becomes “new idea day,”¹⁴⁰ in which a sponsor can create new terms, or expand old ones. Once in a single deal, others use that precedent for their own purposes: “The next deal, we put all the terms in the key fee letter, and literally two weeks later, every deal on the market looked like [the first one].”¹⁴¹ As one lender’s counsel put it, “The market doesn’t get moved across every deal. A sponsor sees that deal, and you’re like, ‘Oh, I need that’ . . . Next thing you know, six months later, everybody’s got this pick your poison thing, right? It just happens.”¹⁴²

Against the force of sponsors armed with precedent, lenders deploy market logics to resist, arguing “to hold the precedent” as a way of capturing back some leverage.¹⁴³ But sponsors, who hold the pen, appear quicker to adapt to changing market conditions than lenders.¹⁴⁴ Indeed holding the pen allows the sponsors to set expectations about precedent and thus impose it.¹⁴⁵

Market participants believe that there is a connection between sponsor power and law firms, with consolidation meaning that certain law firms are ever more powerful and able to drive change in firms by strategically asserting the normative importance of the last deal.

Every major sponsor now has consolidated their work at one law firm, their financing work at one law firm, and generally with like one partner or group of partners that services them . . . and the idea being that this one guy or gal is going to be like the expert in everything we’ve agreed to in every deal, and we are going to hold the line on our form, and we are going to impose it on everybody.

So you think about like Paul Weiss has a whole operation dedicated to Apollo, right? There are people whose only job is

¹³⁹ Interview with Lender’s Counsel 2.

¹⁴⁰ Interview with Borrower’s Counsel 2.

¹⁴¹ Interview with Borrower’s Counsel 1.

¹⁴² Interview with Lender’s Counsel 5.

¹⁴³ Interview with Lender’s Counsel 2.

¹⁴⁴ Interview with Lender’s Counsel 1.

¹⁴⁵ Interview with Borrower’s Counsel 2.

to make sure the Apollo form is current and doesn't get messed with.¹⁴⁶

That is, lawyers with better access to precedent can charge higher rents.¹⁴⁷ Our respondents also universally agreed that precedent deteriorates rapidly with time. They generally agreed that the last 3-5 deals in the relevant space are the precedent. Deals more than a “few months” old are weaker precedent than newer ones,¹⁴⁸ and deals outside of the loans current industry less apt.¹⁴⁹ While some describe this as an empirical standard, i.e., 20-30 deals rated across internal databases,¹⁵⁰ others think of market precedent in a more sociological way: market arises out of the consensus views of active dealmakers.¹⁵¹

The problem is that these precedent battles can often be inconclusive:

¹⁴⁶ Interview with Borrower's Counsel 3.

¹⁴⁷ Interview with Entrepreneur 1 (“If you're a public borrower, you go to Wachtell or Skadden or Kirkland because they get the best terms historically, and they have vast database . . . and if you're a lender. You're going to Proskauer and Gibson for that same service, because they have the best service.”)

¹⁴⁸ “We do try to get as recent market precedents as we can, and if there were a deal from like two months ago versus 18 months ago, I would put a lot more weight on what was more recent.” Interview with Lender's Counsel 2

¹⁴⁹ “We'll try and get comps that are similar, you know. 1st of all, always the same sponsor, right? Because that'll be huge, like, you're not gonna comp like a you know, if it's a Carlyle deal. You're going to go and look at like a mid market precedent that . . . Barclays [did with] random mid market PE firm, because that's not gonna be helpful for them. It needs to be like with the same sponsor.” Interview with Lender's Counsel 1.

¹⁵⁰ Interview with Loan Information Intermediary 1 (“So like the you know, we look at all the deals that cleared market in the prior 3 month period to get [the relevant comp].”).

¹⁵¹ Interview with Borrower's Counsel 3 (“I don't, you know, you'll talk to some lenders lawyers, but like they and I could agree on like what the reasonable bounds of outcomes here are right, and like we can all find precedents for them. And then it's [where we end up is] going to be like, based on the specific situation where we end up. And sometimes it's about like the facts and circumstances on the ground of like what the company is, and whatever but more, it's about what's happening in the market.”); Interview with Lender's Counsel 5 (“I see tons of deals. They ask us, What's market? What are you seeing for other deals in the market? Other sponsors, other deals done by this sponsor?”); Interview with Borrower's Counsel 3 (“And sometimes it's about like the facts and circumstances on the ground of like what the company is, and whatever but more, it's about what's happening in the market.”).

And how you define the scope of relevant precedent is really important, right? Because, like what banks routinely do is they'll send your client either anonymized precedent charts, or they'll send them with actual names. But they'll just cherry-pick like all the shit that's best for them, right?

They'll be like, you know, I've had clients that are in like a very, like, you know, they insure student debt or something—like a super narrow field. There are only three companies in the world that do this, and the banks will say, 'The relevant precedent set is companies that insure student debt,' and you're like... it's three.

Maybe they [the other two] didn't care at all about their debt. Maybe they hired some, you know, knucklehead from who knows where to negotiate it. Like, why is that the relevant set? Why isn't it all insurance companies? Why isn't it all high-yield companies

That's why a precedent battle can be kind of a waste of time in some sense. Like, it's informative, but it doesn't solve the problem.¹⁵²

When precedent battles don't work to maintain lender power, they sometimes use recourse to other legal terms, particularly the ability to flex: "A smart sponsor knows that they don't need certain things, and so what the banks can do is they'll come to them and say, 'Hey, I can flex down your MFN crap. I can flex out your 30 times investment basket, and then I don't have to price flex. You would rather do that, or would you rather pay more?'"¹⁵³ Flex permits a lender whose paper has not sold well to modify certain terms to make sure that the entire package sells. Pricing flex is the "largest arrow" in lenders' quiver.¹⁵⁴ In practice, it operates as "an insurance policy. If the market changes between signing and closing, or between signing and syndication launch, ... [banks] have the ability to tweak, they generally only underwrite terms [they think they can sell]."¹⁵⁵

¹⁵² Interview with Borrower's Counsel 3.

¹⁵³ Interview with Lender's Counsel 5.

¹⁵⁴ Interview with Lender's Counsel 1.

¹⁵⁵ Interview with Lender's Counsel 4.

IV. IMPLICATIONS AND EXTENSIONS

This Article's core aim is to describe an irreducibly social practice that is endemic to commercial contracting and to explain it within an economic framework. Details of precedent contracting will surely vary across dealmaking environments. The scope of precedent will be wider or narrower, its weight heavier or lighter, the role of mediating institutions will be more or less central, and so on. We believe, however, that the category and logic we identify will prove tractable upon investigation of a wide range of deal types. Suppose we are right. What follows?

Recognizing precedent terms as a distinct category reframes longstanding debates across contract scholarship. Rather than treating negotiated-but-unpriced variation as anomalous, it suggests that much of what matters in commercial contracting occurs on a margin that existing models do not reach. The implications for empirical method, doctrinal interpretation, and the study of transactional practice follow directly.

If so, a good deal of familiar analysis has been training on the wrong margins of contractual variation. This section discusses what it means to recognize a substantial role in contract production for precedent terms. To that end, we remark on five implications for those who study and teach commercial and corporate dealmaking. We then consider the relationship between precedent contracting and breakthroughs in computing technologies.

A. Points of Contestation

Before considering implications, it is useful to mark the commitments our account makes and, with them, the natural grounds for disagreement. We have argued that many sophisticated contracts contain a class of economically meaningful terms for which parties cannot form usable estimates of marginal value, and that variation in such terms is nonetheless negotiated. A reader who believes that improved modeling, deeper datasets, or better-designed empirical strategies will eventually reveal price sensitivity along these dimensions will not share this premise. On that view, what we call precedent terms are simply best-possible terms viewed through a temporarily cloudy lens. Our own view is more skeptical: for a large class of terms, the informational and computational demands needed

to support even coarse marginal valuation are unlikely to be met.¹⁵⁶ But this is a difference in judgment about markets, not a matter that can be settled by definition.

A second point of contestation relates to categorization. We have treated precedent contracting as a distinct mode of term specification, rather than a transitional stage between idiosyncratic contracting and full standardization. A critic might imagine that the terms we highlight are simply gestating boilerplate: that, given time or coordination, they will settle into invariant forms. Others might take the opposite view: that parties do have meaningful priors about value and that any apparent normativity is better explained by agency costs or local bargaining conventions. These positions are not inconsistent with observed practice in every setting, and several could be true in different markets. What matters for present purposes is that our account identifies a domain where neither price nor standardization appears to do the work theory assigns to them. Whether that domain is narrow or wide is a question on which readers can and should differ.

A third site for potential disagreement is explanatory. We have offered a functional rationale for reliance on precedent where measurement fails, but other accounts are possible. One might emphasize lawyer incentives, or cognitive shortcuts, or the inertial pull of familiar forms. These alternatives generate different expectations about how terms will drift, how shocks propagate, and how quickly markets incorporate new information. We have not attempted to adjudicate among them. Our claim is simply that any explanation must take seriously the fact of negotiated but unpriced variation and the role of prior deals in structuring it.

We foreground these points not to narrow debate but to locate it. If our description is accurate, a substantial share of contracting activity takes place on a margin for which standard tools—both theoretical and empirical—offer limited traction. A reader convinced otherwise should say so, and should explain whether the dispute lies in the scope of the category, the distinctness of the mechanism, the underlying behavioral assumptions, or the interpretation of market practice. The argument of this Article should be understood as an invitation to pursue those questions directly.

¹⁵⁶ Though, perhaps, AI will prove us wrong, as we explore below.

B. Implications for Research and Teaching

1. Calibrating and Interpreting Empirical Research.

The event study is a—perhaps the—go-to empirical research method in commercial and corporate scholarship. Event studies begin with a shock to the enforceability or meaning of a standard term, or to a legal rule that affect the allocation of power between parties. So armed, researchers seek, through more or less sophisticated designs, to measure the marginal change in a quantity of interest—often a price term—that can be attributed to the changed governance parameter. It is a compelling approach. Its widespread use in commercial and corporate governance contexts, though, is premised on the notion that an investment’s price is sensitive in some rational way to the variable being studied. Usually that assumption is not farfetched. The variable being studied might be contested. It seems to be economically significant. (Hence the researcher’s interest.) It *should* matter.

Our intervention suggests reason to be skeptical of the enterprise. Event studies have come in for criticism recently from multiple angles, but those criticisms are generally technical.¹⁵⁷ Precedent contracting levels a more foundational criticism: the premise of price sensitivity which underpins most event studies does not hold for many variables, particularly in complex contracts.

This insight has concrete implications for both the use and interpretation of event studies. On one hand, it counsels caution to researchers who would like to explore the (price-mediated) implications of a governance term. Before sinking time into the study, one might want to satisfy oneself that the term of interest might realistically be priced. That is a market-specific question, of course. The higher a term’s stakes and the more easily market participants can evaluate its marginal contribution to returns—for example because it interacts linearly with other risk variables—the more plausible a pricing assumption will be. On the other hand, consumers of empirical

¹⁵⁷ See, e.g., Jill E. Fisch, Jonah B. Gelbach and Jonathan Klick, *The Logic and Limits of Event Studies in Securities Fraud Litigation*, 96 TEX. L. REV. 53 (2018) (highlighting limitations of event studies). We don’t wish to overstate the regularity of null results. Some event studies, especially studies of publicly traded equities, disclose statistically significant results. See, e.g., Aggarwal, *supra* note 35 (finding that markets price the ability of merger targets to recover damages on behalf of shareholder in the event of breach).

research might also need to update their priors about what an event study *ought* to reveal. They might need to become more skeptical of statistically significant findings, to demand stronger evidence of a term's price impact.

At the same time, they might be less perturbed by inconclusive findings. As we explored above, a persistent puzzle in the literature is the absence of evidence that investors price secondarily important contract terms, even in response to what looks to observers like significant stimuli.¹⁵⁸ Scholars have generally attributed these failures to noisy data, or the presence of agency costs. But the field still assumes that in the absence of agency costs, and with a big enough sample, we should see pricing, particularly where the contracts themselves trade and are not merely trailing parts of the real deal.¹⁵⁹ We suggest a different baseline: the absence of price effects could be diagnostic of a category where measurement costs—particularly, the complex interaction of terms and future states of the world—make pricing prohibitively expensive. Scholars shouldn't prefer agency cost explanations—to blame or credit the lawyers for distortions—to informational ones. If a researcher studies a precedent term, null price effects should be expected, not taken as evidence of pathology.

2. *Inferences from (or to) Efficiency.*

Taking precedent contracting seriously should also weaken Panglossian inferences to the effect that observed terms are inherently efficient. Few academics hold—or ever held—to the caricature of first-generation law & economics reasoning. The literature on boilerplate, if nothing else, has conclusively undermined the pretense that any commercial contract is a product of first-best Coasean design.¹⁶⁰ The notion that a contract party internalizes the social costs of inefficient control rights on which it insists, through the price term, is still, however, a powerful heuristic in the discussion of corporate and commercial law. Our study of the leveraged loan market suggests that,

¹⁵⁸ See *supra* text accompanying notes 34–37.

¹⁵⁹ Cf. Arthur Allen Leff, *Contract as Thing*, 19 AM. U. L. REV. 131 (1970).

¹⁶⁰ Michael Klausner, *The Contractarian Theory of Corporate Law: A Generation Later*, 31 J. CORP. L. 779, 797 (2006) (summarizing literature).

unless it is a peculiar market, the line of reasoning should hold for relatively few dimensions of a commercial or corporate contract.

In certain corners of the corporate contracting literature, it's become anodyne to suggest that positive transaction costs, network learning externalities, weak incentives for state competition and other barriers to Coasean contracting make it impossible to conclude that we observe a race to the top in the corporate form.¹⁶¹ We argue that the prevalence of precedent terms implies the same is generally true in commercial contracting: there simply is no good reason to think that any particular term reflects anything like surplus-maximizing allocation of decision rights. A system as a whole might have groped toward some evolutionary optimum—or might not—but there is little reason to think that any particular parameter is optimal.

3. *Sociological (Ethnographic?) Approaches to Contract Formation*

If these considerations are pessimistic about the capacity of statistical methods to reveal the mysteries of corporate and commercial contracting, they are relatively optimistic about the possibilities of sociological approaches. Others have, of course, called for putting sociology at the center of contract scholarship.¹⁶² And much recent work on boilerplate, led by Gulati, Scott and Choi (and joined by others) certainly has generated important contributions with qualitative interviews.¹⁶³ Our view is that contract scholars need to cultivate an institutional sense of their market of interest even to develop hypotheses about the appropriate methods of study of the issues they care about. What's needed is iteration between a theory of the relevant market and local information about its structure.

This is no simple task. Market participants are good sources of information, but research cannot simply aim to transcribe their self-understanding. Interviews disclose first and foremost the phenomenology of daily participation in a market. The constraints under which practice takes the form it does are seldom observable. The butcher and baker were never meant to see the invisible hand that transforms their self-interest into consumer welfare. In general, market

¹⁶¹ *Id.*

¹⁶² Most notably, Suchman, *supra* note 16.

¹⁶³ *See generally* Scott, Choi & Gulati, *supra* note 3.

participants need not be aware of emergent properties of the contracts they produce. At the same time, a researcher's foundation in practitioner experience may be indispensable to forming a plausible model of dealmaking where precedent contracting looms large.

A sociological approach will be important to shedding light on a number of discrete issues. One is how the construction and weight of precedent works in different areas of legal practice. Contract sociologists have long been interested in the difference between thick and thinly tied networks in generating pressure to keep promises.¹⁶⁴ An open question is whether thicker-tie networks are necessary to precedential negotiation. Our preliminary investigations of the leveraged loan market strongly suggests that the familiarity that participants have with one another, and the expectations that they are all participants in a choreographed dance, make precedential arguments more powerful. It would be useful to evaluate this intuition in markets with weaker ties—to see if, in fact, precedent matters less and explicit price signals matter more.

Similarly worth investigating would be the waxing and waning of the normative power of precedent in different economic conditions. In the loan market, contract terms seem to attract more attention in topsy-turvy economic conditions than in placid ones.¹⁶⁵ That economic conditions cause changes in previously sclerotic terms seems eminently sensible. But we'd be interested in knowing if market loses its constraining force because the precedent has a shorter half-life for rational reasons, or whether defectors from the normative system simply become more common. Indeed, a different hypothesis would be that in ordinary and calm markets, participants might be *more* willing to experiment on terms, because only when they can hold all else constant can designers learn if their inventions are value enhancing.¹⁶⁶

¹⁶⁴ See, e.g., Barak Richman, *An Autopsy of Cooperation: Diamond Dealers and the Limit of Trust-Based Exchange*, 9 J. LEG. ANALYSIS 247 (2017) (on the breakdown of trust in diamond industry after the breakdown of trust and thinner network); Sadie Blanchard, *Contracts Without Courts or Clans: How Business Networks Govern Exchange*, 57 GA. L. REV. 233, 289 (2022) (focusing on network ties in reinsurance market).

¹⁶⁵ Interview with Lender Counsel 5.

¹⁶⁶ We thank Jon Klick for this idea, which he concedes is unfalsifiable.

4. *Accounting for Lawyers' Observed Use of Precedents.*

For a generation or more, scholars have noticed two features of commercial contracting that existing theory did not easily explain: first, that even tradeable commercial contracts contain variable parameters (i.e., that the end-stage of financial contracting isn't a monoculture);¹⁶⁷ and, second, that lawyers find value in knowing "what's market" when negotiating.¹⁶⁸ There has not, however, been an account that explains these facts satisfactorily or indeed that links them.

Precedent contracting simultaneously explains, without necessarily advertent to agency costs, why a lawyer's knowledge about past deals should be valuable to clients and why non-price terms vary without obviously affecting price.¹⁶⁹ Parties value a lawyer's knowledge about the contours of prior deals precisely with respect to features of the deal that they know they cannot feasibly price. Those are the terms the variation in which will be felt, so to speak (since it won't be offset through the price term). Consequently, they are the dimensions of the deal on which parties want protection or indeed to gain an advantage. And, at the same time, they are the dimensions on which knowledge of the past is useful for achieving the desired end, since, as in all precedential reasoning, descriptive norms have a prescriptive edge.

5. *Specifying Boilerplate.*

Precedent terms suggest a more limited and precise definition of boilerplate and therefore a more focused scholarly inquiry. As used in the literature, the concept is often ambiguous and suggests several distinct properties: boilerplate terms are those that are not salient, that are standardized, that are in "fine print."¹⁷⁰ Precedent terms provide an illuminating analytic contrast, in the sense that they can employ highly

¹⁶⁷ Choi and Triantis, *supra* note 20, at XX.

¹⁶⁸ Indeed, Elisabeth de Fontenay has argued that this kind of social knowledge is what big law firms really sell their clients. De Fontenay, *supra* note 5.

¹⁶⁹ One way that such terms do affect "price" is that lawyers can charge more for knowledge about their normative weight, which, obviously, they do. Interview with Entrepreneur 1 (suggesting that lawyers with access to better precedent information can charge premium rates).

¹⁷⁰ Natasha Sarin, *Making Consumer Finance Work*, 119 COLUM. L. REV. 1519, 1562-58 (2019) (discussion of salience).

standardized language and appear in the recesses of a (very) long document but are nevertheless central to the work of negotiation. Boilerplate, then, should refer only to terms that market participants do not regard as being “up for grabs” in a negotiation. From that definition it follows that any differentiation in a boilerplate term, unlike in a precedent term, is accidental in the sense that it is residue of the path dependent evolution of individual forms.

So specifying the concept would clarify research paradigms. For example, it would call for mergers clauses to be studied as precedent terms, while leading to boilerplate analysis such non-negotiated terms as waiver of a jury trial, choice of law, and the like. Different approaches are called for. For example, there is no reason to expect the random walk of locked-in drafting error—apparently prevalent for standardized provisions¹⁷¹—to affect boilerplate and precedent terms similarly. If evidently suboptimal precedent terms persist across time, we should reach for different explanations than the cost of changing a standardized form.¹⁷² A narrower definition might also helpfully provoke questions about boilerplate’s origin. Gulati and his co-authors have argued that boilerplate can look like a black hole, where no information about its meaning is recoverable. But the forces that produce this mysterious good are obscure: what, beside network externalities, will push variable precedent terms over the standardization event horizon?¹⁷³

C. Obligatory Nod to AI and the Death of Lawyering

No wide-angle discussion of interaction between law and market institutions can avoid confronting the significance of breakthroughs (and presumed future advances) in computing technology. Ours is no exception. Precedent terms are, as we have said, a product of the practical limits to the analysis of information that prevail in a particular contracting environment. Rapid advances in artificial intelligence or

¹⁷¹ See generally MITU GULATI, BOB SCOTT AND STEPHEN CHOI, THE PARADOX OF CONTRACT PRODUCTION (forthcoming) (describing pathologies in standardized terms across markets and offering a general contract production theory).

¹⁷² We see Tallarita’s recent work as fundamentally supporting this idea, though in a different institutional context. Tallarita, *supra* note 45, at XX (discussing norm driven account of corporate governance terms).

¹⁷³ Choi and Triantis, *supra* note 20, at XX.

other computational techniques thus threaten not only the stability of contracting practices in any given market but perhaps even the descriptive utility of the dynamic this article identifies. We wonder what might change when market participants are assisted by algorithms that “know” about far more interactions of far more contractual parameters pertaining to far more deals.¹⁷⁴

Our analysis challenges the notion that lawyers’ knowledge of past deals exhausts their value. Lawyers are valuable in large part because they help to constitute the kinds of normative bargaining environments in which precedent contracting is possible. Yet the conditions for such negotiations are not spontaneously generated. They are created socially by party representatives—often lawyers—who are familiar with the parameters of recent deals but also competent in using them. Just as a litigator must not only know the case law but also, more importantly, have the feel for getting the most out of its power and limits, so the valued transactional lawyer tacitly understands how to protect her client by deploying, not just cataloging, information about what has been done before.

To see the idea differently, suppose that tomorrow all loan market participants had access to a low-cost database of an arbitrarily large number of variables corresponding to every loan deal and arbitrarily large amounts of computing power and ask what would change about the terms of newly struck deals.¹⁷⁵ Our hypothesis is that not much would change, and that law firms in particular would fare about as well, because precedent doesn’t function (just? mostly?) to identify value but rather set the normative parameters of the deal itself. The lawyers build that normative system, which has value to their clients. But what’s being sold isn’t exactly an empirical bill of goods. Recall what a senior borrower’s counsel said: given parties’ freedom to pick their deals, a “precedent battle can be kind of a waste of time in some sense. Like, it’s informative, but it doesn’t solve the problem.”¹⁷⁶ Negotiation

¹⁷⁴ For evidence of this product starting to appear in the market, see *Benchmark Corporate Transactions With Noetica’s New Report Data*, May 8, 2025, available at <https://legal.thomsonreuters.com/blog/benchmark-corporate-transactions-with-noeticas-new-report-data/?cid=soc&chl=linkedin&postid=50aoce5e-f75c-4002-a1ea-7469696c5e9e> (describing product that uses a “proprietary AI to transform transactional terms into quantified data and broad market insights”).

¹⁷⁵ *Relatively* low cost. Obviously *we* couldn’t afford it.

¹⁷⁶ Interview with Borrower’s Counsel 3.

is about more than prediction or extrapolation from trends; it involves argumentation about the past's bearing on the future.¹⁷⁷

If data and computation are to alter contracting practices fundamentally, they will do so, it seems to us, by allowing parties to assign prices more confidently to more terms or combinations of terms. As data multiply and machine learning (and related) techniques improve, one could imagine that complicated interaction effects will become more tractable.¹⁷⁸ This would drive down the measurement costs that explain precedent contracting in the first place. More terms would become “best possible,” and the value of intermediaries such as banks and law firms would decline on the margin. The refrain is that precedent contracting is optimal only in a world of second-bests, where best possible contracting is infeasible. If the first-best were to become feasible, the social practice would go the way of other defunct rituals of contract formation, like the wax seal.

CONCLUSION

The account we have offered exposes a gap in the familiar assumption that terms either shape price or standardize into boilerplate. That binary omits a third, consequential category. Commercial contracts include provisions that matter economically and vary from deal to deal but do not influence price. Such terms are contested, because assigning a value to marginal variation is infeasible but parties recognize that standardization won't do. This unpriced domain is where much of sophisticated bargaining occurs, and any theory that overlooks it will misdescribe how contractual surplus is actually distributed.

The analysis of leveraged loans reveals that precedent terms are particularly prevalent where the costs of standardization are prohibitive and price differentiation remains infeasible. The evolution of MFN clauses, sponsor protections, and other leveraged finance terms illustrates how precedent serves both as a constraint and a tool.

¹⁷⁷ This is not to say *nothing* will change. There will be positional shifts as firms lose the ability to capitalize on informational asymmetries.

¹⁷⁸ Interview with Entrepreneur 1 (describing a future state after terms are quantified which would “allow the principal parties to eventually obviate the need for negotiation and just include it in the rate”).

Sophisticated borrowers, particularly private equity sponsors, use precedent to expand favorable terms across deals, while lenders attempt to resist changes by anchoring arguments in historical norms. This process creates a feedback loop that drives the incremental evolution of contract provisions over time.

By identifying precedent terms as a distinct category, this Article provides a new lens through which scholars and practitioners can analyze the evolution of contract drafting. Rather than being solely the product of economic efficiency or legal inertia, precedent terms reflect a dynamic process in which parties rely on history not only to signal normative expectations but also to structure negotiations in a way that mitigates uncertainty. This insight has deep implications for understanding commercial contracts in varied markets. Our bottom line is that optimal contracting models should not assume that varied terms' value flows through to contract price. In this sense, precedent contracting should not be understood as a deviation from optimal contracting, but rather as a call to extend the associated theory to incorporate the insights of ecological rationality where the price mechanism runs out.

Recognizing precedent terms as a foundational component of commercial contracting may also have implications for regulatory and judicial interpretation. Courts and policymakers seeking to interpret disputed contract provisions should be attuned to the ways in which precedent terms function within their respective industries. Unlike boilerplate, which reflects network effects and path dependency, or priced terms, which are subject to explicit economic trade-offs, precedent terms derive their force from social and institutional practices that cannot be reduced to simple economic modeling.

Finally, the rise of AI and data-driven contract analytics poses both opportunities and challenges for the future of precedent terms. While greater computational power may improve parties' ability to estimate the economic significance of certain provisions, it remains an open question whether such innovations will disrupt the norm-driven negotiation process that underpins precedent terms. If algorithmic tools can successfully price terms that are currently unpriced, the balance of power in contract drafting may shift away from legal practitioners toward financial engineers and data-driven investors. Conversely, if the fundamental uncertainty surrounding precedent terms persists, then their role in structuring commercial relationships

will remain intact, reinforcing the centrality of precedential reasoning in contract design.

In sum, this Article calls for scholars, practitioners, and policymakers to take precedent terms seriously as an independent category of contractual provisions. Understanding their function is essential not only for explaining empirical anomalies in contract negotiation but also for refining our theoretical models of commercial contracting. By incorporating precedent terms into the broader study of contract law, we can better grasp the mechanisms that drive contractual innovation, surplus allocation, and the evolving landscape of transactional practice.