# CONSTRUCTING AN APPROACH TO ENDOGENIZE NORMS OF COOPERATION FOR THE ENTREPRENEURIAL VENTURE(R)

*Michael R. Bell*[1]



---

1. Partner, M. Bell & Associates, P.C., Tulane Law School Intersession Faculty (Transactions Practice Track) 2012 and 2013; JD, Tulane Law School; BA, Howard University. I would like to thank Onnig Dombalagian for his comments on prior drafts of this paper, and Adam Feibelman for his insights on the legal publication process.

## I. INTRODUCTION

### A. Locating The Institutional Focus Of The Analysis

When scholars or legal decision-makers[2] advocate support for instrumental uses of law, such as for methodologies or approaches designed to encourage the development of certain norms thought welfare-enhancing, the institutional arrangement to which such efforts are directed must be expressly incorporated into the analysis.[3] The specific institutional

2. The term "legal decision-makers" is from an article by Edward L. Rubin (see Edward L. Rubin, *The Practice And Discourse of Legal Scholarship*, 86 MICH. L. REV. 1835, 1847 (1988). Professor Rubin identified the audience for prescriptive scholarship as "judge, and occasionally to a legislator, administrator, or equivalent public decision-maker." *Id.* at 1850. My use of the term "legal decision-maker" is intended to mirror the list identified by Professor Rubin: judges, legislators, administrators, or equivalent public decision-makers, but also those institutions which have developed over time to aid the law's evolution. These other institutions include organizations such as the American Law Institute (ALI) and National Commission On Uniform State Laws (NCUSL), among others. *See generally* Robert D. Cooter, *Decentralized Law For A Complex Economy: The Structural Approach To Adjudicating The New Law Merchant*, 144 *U. Pa. L. Rev.* 1643, 1650 (1996).

3. *See* Rubin, *supra* note 2, at 1890-91 ("To begin with, modern judges regularly invoke social policy, but they possess no general framework for determining the content of that policy, or the way that it should interact with doctrinal argument. While this lack of clarity permits policy to be used as a kind of *deus ex machina,* whose sudden appearance produces the desired result, it also generates a sense of discomfort among conscientious judicial decision-makers. Because they must decide cases one at a time, however, most judges cannot articulate a comprehensive policy approach in advance of their decisions, nor can they trace the normative implications of the policy they articulate in each decided case.

arrangement offers the social context in which to evaluate the effectiveness of one approach versus another.[4] If the institutional arrangement is the entrepreneurial venture, for example, then the analysis can be directed to factors at play which bear on that arrangement.

What generally has not been explored in the literature is how the nascent or start-up venture[5] is handicapped when compared to more established businesses or co-venture parties that also seek to form mutually beneficial strategic alliances. Individual nascent venture parties who join together within a new firm in an attempt to commercialize[6] a new product or service, agree to create an organization sharing the common characteristics of collaborative agreements,[7] characteristics which also define more mature, individual firms who collaborate via a joint venture, for example. Conceptually, any notion where we might unwittingly assign standing to start-up venture parties, which is at significant variance with that of more seasoned co-venturers, might be ferreted out by determining whether we ascribe higher or different expectations to one arrangement or the other. That exercise cuts to the heart of the concepts explored in this Article. If we employ a comparative analysis of two institutional arrangements (i.e. the nascent collaborative venture and the joint or other collaborative venture of seasoned parties), which are created for similar purposes (i.e. the

---

Only legal scholarship is likely to produce a sustained elaboration of social policy approaches, and an exploration of their interaction with existing doctrine.").

4. *See* Jack M. Beerman, *Contract law As A System Of Values*, 67 B.U. L. REV. 553, 560 (1987) ("One of Collins's most important methodological points is that contract rules must be analyzed in the context of particular market realities. In other words, different market arrangements need different legal frameworks; therefore, in order to criticize the law, one must have a clear picture of the social arrangement to be regulated."); *see also* Edward L. Rubin, *The New Legal Process, The Synthesis Of Discourse, And the Microanalysis Of Institutions*, 109 HARV. L. REV. 1393, 1394 (1996).

5. This Article will interchangeably refer to the start-up or emerging venture as the "nascent" venture, or "nascent" entrepreneurial venture, etc. Also, the terms "start-up" or "emerging" or "nascent" venture each refer to the type of closely-held entrepreneurial collaboration of the type described in the hypothetical of Part II.B. of this Article. These types of ventures have not matured, as it were. They are either new entities or have not operated for a lengthy period of time, and are deemed to have not fully implemented or exploited the entrepreneurial opportunity for which the entities were formed. The "nascent" venture stands in contrast to what this Article refers to as "established" or more mature/sophisticated parties or entities. These "established" parties or entities have operated for an extended period, are often managed/owned by sophisticated parties who have engaged in frequent business transactions, and where the business purposes of the venture either have been more fully realized, or where the parties have a clearer strategic direction in implementing the venture.

6. *See* D. Gordon Smith & Masak Ueda, *Law And Entrepreneurship: Do Courts Matter*?, 2 ENTREPRENEURIAL BUS. L.J. 353, 357 (2006) (refers to the "commercialization of entrepreneurial opportunities.").

7. *See infra* Part II.B.1.b.

exploitation of an economic opportunity),[8] but one such arrangement is thought to have certain advantages which better equips that arrangement to achieve the broad purpose that the two arrangements have in common, then it is worthwhile to explore why that is the case and how we might improve the odds of the least advantaged arrangement. Pursuit of that examination may point to factors which are exogenous to the arrangements (such as the particulars of specific governmental legal regimes) or factors which are endogenous to the arrangements (such as the deliberate development of certain norms by the parties, norms believed to facilitate their venture purpose).

Like more experienced co-venture parties, the collaborative parties in nascent or start-up ventures undertake an equally ambitious effort to leverage the skillsets and competencies of their co-venture parties. Yet, in this Article's view, nascent ventures can be disadvantaged relative to certain more experienced co-venture parties due to the strength of reliance that each association may be inclined to place on cultivating relational contracting[9] strategies in the initial venture planning stages. While certainly not true in every case, there is more than anecdotal evidence to suggest that parties more experienced in implementing collaborative ventures are more likely than start-up collaborators to devise approaches geared towards strategic norm development in an effort to enhance venture prospects. The appeal to strategies focused on contracting in ways designed to cultivate norms of cooperation[10] in initial venture planning does not necessarily represent a rejection of the standard process offered by way of classical contract's

---

8. *See* Steven H. Hobbs, *Toward A Theory Of Law And Entrepreneurship*, 26 CAP. U.L. REV. 241, 265 (1997) ("Entrepreneurship is the process of creating value by pulling together a unique package of resources to exploit an opportunity.").

9. Ian Macneil is most closely associated with what are known as relational contracts. Ian R. Macneil, *Contracts: Adjustment of Long-Term Economic Relations Under Classical, Neoclassical, And Relational Contract Law*, 72 NW. U.L. REV. 854 (1978); *see also* Peter Linzer, *Uncontracts: Context, Contorts And The Relational Approach*, 1988 ANN. SURV. AM. L. 139, 155. Relational contracts, broadly construed, involve on-going relations between the parties to a contractual agreement, as in the collaborative arrangement among parties who join together to implement an entrepreneurial venture. As such contracts do not represent discrete, one-time transactions (such as a consumer sales transaction, for example), not all the contingencies can be precisely contracted for in advance. There is an inherent level of uncertainty due to the time between contract execution and future performance. *See* Robert E. Scott, *Conflict and Cooperation In Long-Term Contracts*, 75 CALIF. L. REV. 2005, 2010 (1987) ("Transactions are characterized as either relational or discrete indicating the extent to which the parties are (or were) in ongoing relationships rather than isolated or one-shot exchange transactions."); *see also* Jean Braucher, *Contract Versus Contractarianism: The Regulatory Role Of Contract Law*, 47 WASH. & LEE L. REV. 697, 708 (1990).

10. In this Article, the term "norms of cooperation" is broadly construed to include the goals of cooperation, reciprocity, compromise, participation in decision-making, trust and such other like goals. *See* Braucher, *supra* note 9, at 728; Robert A. Hillman, *The Crisis In Modern Contract Theory*, 67 TEX. L. REV. 103, 124 (1988).

emphasis on ex-ante presentation,[11] with its goal of initially executing a complete contract addressing all future contingencies.[12] But, while the predictability of classical contract is still valued, it is not the sole, or even principal consideration among factors thought best in all situations to achieve the aims of the collaborative undertaking.[13]

Rather than delving into specific details of any particular relational contracting approach, this Article's focus is on the core rational for many of the relationship building approaches that have been surveyed in the literature[14]. Whether through "strategic bundling,"[15] "sequential contracting"[16] or the "braiding" strategy described by Professors Gilson, Sabel, and Scott,[17] most such strategies exemplify venture party adherence to a core belief: Cooperation, fleshed out in its several facets, viewed as an object of the collaborative venture,[18] is a norm with premium value as a tool

---

11. *See* Steven R. Salbu, *Joint Venture Contracts As Strategic Tools*, 25 IND. L. REV. 397, 398 (describing "presentiation" as the restriction of future effects through definition and stipulation in the present); Linzer, *supra* note 9, at 156-57 ("To 'presentiate' means to move the future into the present. In classical contract theory the parties are required to spell out at the time of contracting what should [happen] when things happen in the future.").

12. *See* Salbu, *supra* note 11, at 405 ("The classical goals of discreteness and presentiation are unattainable, most significantly because all eventualities cannot . . . be foreseen between contracting parties. A contract cannot be discrete because it exists in an open system of environmental change, and it cannot attain presentiation because the parties are neither prescient nor in full control over a wide array of potential . . . contingencies.") (footnote omitted).

13. *See* Larry A. DiMatteo, *Strategic Contracting: Contract Law As A Source Of Competitive Advantage*, 47 AM. BUS. L. J. 727, 778 (2010) ("Strategic ambiguity in the joint venture agreement may provide incentive for greater cooperation and at the same time may amplify the perception of shared risks."); *see also* Salbu, *supra* note 11, at 410-11 ("The socialization of attorneys is deficient in its failure to educate lawyers who understand the needs of their clients for mediation, compromise, flexibility, and a tolerable level of strategically advantageous ambiguity.").

14. *See infra* Part III.B.

15. Larry DiMatteo describes "strategic bundling" as "aligning a number of serial contracts. In this way, the companies may gradually build a strategic alliance through the sequencing of a number of discrete contracts followed by an agreement for continuing collaboration. The strategic beauty of such a preconceived scheme is that the contracting parties can test each others capabilities and reliability before agreeing to a long-term arrangement." DiMatteo, *supra* note 13, at 737.

16. *See* Scott, *supra* note 9, at 2010, n.12 ("By arbitrarily construing the duration of the contract, the parties can reduce both the uncertainty regarding the magnitude of future contingencies and the complexity of assigning . . . risks.").

17. *See* Ronald J. Gilson, Charles F. Sabel, & Robert E. Scott, *Braiding: The Intersection Of Formal And Informal Contracting In Theory, Practice, And Doctrine*, 110 COLUM. L. REV. 1377, 1382 ("These parties write contracts that intertwine elements of formal and informal contracting in a way that allows the parties to assess each other's disposition and capacity to respond cooperatively to unforeseen circumstances.").

18. *See* Gilson, *supra* note 17, at 1403 (noting that some of the experimental literature and contemporary contract theory incorrectly assumes "that the level of trust and hence availability of informal enforcement – here, confidence in a partner's reliability based

of production.[19] Relationship-building approaches to contract are designed to help co-venture parties ascertain the dispositions of their partners so that they can determine their partners' inclination towards cooperative behaviors,[20] ex post, in an atmosphere of "heightened uncertainty," and upon the occurrence of "unforeseen circumstances."[21] One way to view these relational contracting strategies is to liken them to "pre-contract contracts": They are not preliminary agreements of the sort that would be unenforceable under the indefiniteness doctrine of the common law of contracts[22], but neither do they represent the type of immediate long-term contract where parties are bound, ex ante, by hard, fixed terms that carry forward for an indefinite period into the future. These relationship building strategies afford the contracting parties a "test run," if you will.

If more sophisticated co-venture parties embarking on strategic collaborations have found, through experience, that certain relationship building contracting practices are beneficial to the success of their ventures, then the question arises, "How can those strategies be adapted to the institutional context of the nascent or start-up venture?" In addressing this question, a distinction must be made between (i) the core rationale for such strategies (as stated above), and (ii) the method(s) by which such strategies are implemented. Making this distinction focuses the inquiry on how legal decision-makers might address possible impediments to availing nascent co-venturers of the benefits of more intense relational approaches, impediments which include the likelihood that (1) the nascent venture possesses lower start-up capital and/or (2) nascent venture parties are not as experienced in implementing collaborative ventures and penetrating the market with a new product or service.[23]

---

on some combination of shared norms and the mutual observability of behavior – is an endowment of the actors, exogenous to the relation between them." Rather, the authors observed, "that parties today often treat trust as endogenous, as an object of contracting rather than as a precondition").

19. *See* Alessandro Arrighetti, Reinhard Bachmann & Simon Deakin, *Contract Law, Social Norms And Interfirm Cooperation*, 21 CAMBRIDGE J. OF ECON. 172 (1997) ("Cooperation, in the sense of owners of different inputs working together, is clearly a technical necessity for the process of production, whether it is organized within a single firm or in the form of relations between firms in a vertical supply chain."); *see also* William K. Jones, *A Theory Of Social Norms*, 1994 U. ILL. L. REV. 545, 547 ("When a norm has strong production characteristics, widespread support for the norm is expected over time and across cultures.").

20. *See* Gilson, *supra* note 17, at 1382.

21. *Id.* at 1382, 1385.

22. *See* Jody S. Kraus & Robert E. Scott, *Contract Design And The Structure Of Contractual Intent*, 84 N.Y.U. L. REV. 1023, 1086, 1092 (mentioning non-enforcement doctrine of indefiniteness).

23. *See* Smith & Ueda, *supra* note 6, at 356. Smith and Udea suggest that entrepreneurial firms should be limited to for-profit "new firms" that get "novel things done". However, I am of the view that their use of the term "new firms" is too vague, and

First, while generally true that nascent venture parties have a much higher sensitivity to transactional costs[24] factors than more seasoned co-venturers, in this Article's view, this factor should be viewed as a feature of the contractual environment[25] in which the nascent venture must operate. Within this given contractual environment, legal decision-makers might fashion doctrinally grounded methodologies or approaches designed to compensate for this impediment to efforts to endogenize norms of cooperation. As the main purpose of relational contracting approaches is essentially an effort by private parties to reveal to each other private information helpful in making business investment decisions and the strategies to pursue, then legal methodologies designed to nudge that process along are beneficial. Secondly, even though nascent venture parties might be less experienced in implementing collaborative entrepreneurial efforts, that fact overlooks an important main point about certain norm building strategies implemented by more experienced co-venture parties: the strategies are not inextricably linked to the level of experience in the

---

that even so, the nascent venture certainly could include within its ambit those firms that are *actually* new (such as fresh start-ups), but that it should also include those firms that are a bit more seasoned (i.e. emerging firms), yet which would not be considered established or mature companies. Also, with respect to getting "novel things done" there are numerous entrepreneurial businesses that are not necessarily novel in terms of the services or products offered, but which are successful. These businesses are successful because the individual entrepreneurs running the businesses are effective at attracting clients/customers even where others are offering similar wares. Admittedly, the hypothetical introduced in this Article, *infra*, Part II.B, concerns a venture where the parties are introducing a novel product. For purposes of this Article, examination of the nascent venture with a novel product is presented to help bring into clearer focus the analytical framework suggested herein.

24. Broadly stated, transaction costs in the nascent venture context are the costs associated with negotiating the agreement which governs the venture partners' relationships to each other, and their relationship to the business entity. Gilson, Sabel, and Scott offer an expanded definition of transaction costs which specifically refers to the information costs of contracting:

> The information costs of contracting are incurred in two stages. Ex ante contracting costs are those of anticipating contingencies that may affect efficient performance and therefor efficient investment, and of writing a contract that specifies an outcome for each. Ex post enforcement costs are those of observing and proving any fact relevant to determining the actual state of the world (given the parties have an incentive to misrepresent reality). It is costly to specify what should happen in different future states, and it is costly to prove what actually did happen. Both ex ante and ex post contracting costs prevent parties from writing complete state-contingent contracts.

Ronald J. Gilson, Charles F. Sabel, Robert E. Scott, *Contracting For Innovation: Vertical Disintegration And Interfirm Collaboration*, 109 COLUM. L. REV. 431, 452-453 (2009); *see infra* note 65.

25. The term "contractual environment" refers to the social, institutional and organizational context within which contracts are embedded. *See* Arrighetti, *supra* note 19, at 171; *see also* Scott, *supra* note 9, at 2036 (noting that "contract law has increasingly turned to the contractual environment to supply implied terms").

economic marketplace that such venture parties might possess. The actual *knowledge* that the cultivation of certain norms is valuable to the venture may be acumen born of experience, but the effort at implementing strategies to cultivate certain norms is a purposeful and deliberate action that remains readily accessible to nascent co-venturers. In this Article's view, it is the venture party mindset to place cooperation high in the hierarchy of venture planning strategies which is the prominent feature of an approach to endogenize cooperation. The lesser market experience of nascent co-venturers represents an opportunity for legal decision-makers to apprise start-up venture parties of the importance of cooperation to new venture success and to nudge them in that direction. Also, if there is evidence from the more mature marketplace that certain relationship building strategies are effective, but which have not trickled down to the nascent venture market, legal decision-makers should consider the possibility that there exists certain path dependencies, characterized by sunk costs and complementarities tending to emphasize current arrangements and practices not thought as beneficial to nascent ventures as alternative strategies.[26]

In this Article's view, legal mechanisms and methodologies developed by legal decision-makers, directed towards cultivation of relational contracting practices, and which are compatible in the nascent venture context (including its governing legal regime), can serve as catalysts fostering endogenous change within such ventures. Under the influence of any such new legal approaches, parties to the nascent venture might adapt their contractual strategies more precisely to the social context of their particular, unique economic arrangement. This sets up the possibility for a process of co-evolutionary change with legislators and the judiciary when certain of these new, privately developed strategies come to be respected by legislators and the judiciary as the legitimate and rational practices of those private parties. This process of co-evolutionary change has its roots in the familiar conception in jurisprudence that judges find law by enforcing social norms,[27] but updated to reflect legal decision-makers' more contemporary approach to jurisprudence in also adopting policy justifications in acknowledgment of welfare enhancing practices.[28] Professor Karl Llewellyn's effort at the drafting of the Uniform Commercial Code (UCC) is an example of co-evolutionary change resulting from observation and

---

26. *See* Lucian Arye Bebchuk & Mark J. Roe, *A Theory Of Path Dependence In Corporate Ownership and Governance*, 52 STAN. L. REV. 127, 156 (1999) ("Various players – managers, owners, lawyers, accountants, and so forth – might have invested in human capital and modes of operation that fit the existing corporate rules. Replacing these rules would require these players to make new investments and to adopt to the new rules.").

27. *See* Robert D. Cooter, *Decentralized Law For A Complex Economy: The Structural Approach To Adjudicating The New Law Merchant*, 144 U. PA. L. REV. 1643, 1694-96 (1996).

28. *Id.* at 1695-96.

study of the practices of private parties and the later official adoption of such practices by legal decision-makers.[29] Thus located, this Article's broad applicability lies in its utility as an exploration into the process of legal evolution and jurisprudence, generally, but as applied in the real world context of the contractual arrangements of business parties in the entrepreneurial space, specifically.

B. The Framework Of The Discussion

This Article suggests a type of preliminary analytical framework that judges or other legal decision-makers might employ when seeking to legitimize governmental intervention into private ordering in order to foster the organizational development of norms thought beneficial to private enterprise. The approach taken is to examine the specific institutional context of the nascent entrepreneurial venture, including its distinguishing characteristics, and to identify any broad areas of doctrine or methodologies that can effectively be employed as tools of analysis in that institutional context. Then, in considering points of connection and friction with current practices and jurisprudence, the Article attempts to identify pathways through which judges and other legal decision-makers might premise efforts at laying a foundation upon which nascent venture parties can independently develop norms of cooperation. The law plays a role here that it is well suited for in (i) identifying the features (including the contractual environment) of the nascent venture which should be considered in fashioning instrumental uses of legal rules and methodologies in that context,[30] and (ii) distinguishing the context and contractual environment in which more sophisticated venture parties seek to endogenize norms of cooperation and suggesting an accessible route to that goal, plausible in the nascent venture context.

The Article theorizes that the efforts of legal decision-makers at constructing an approach which might create opportunities for private nascent venture parties to endogenize norms of cooperation will serve to (1) facilitate the development of legal doctrine in this context, and (2) foster contractual approaches developed by the co-venture parties themselves, independent of involvement from legal decision-makers. In order to foster an environment where nascent venture parties can develop such strategies, this Article posits that the efforts should be directed to legal approaches which promote the disclosure of private information. Problems of hidden

---

29. *Id.* at 1651-52.

30. *See* Rubin, *supra* note 2, at 1890-91; Hillman, *supra* note 10, at 124 ("According to Professor Macneil, one must investigate the social conditions that form the foundation of the partners bargains in order to comprehend the relational norms and hence to understand the contract.").

information can lead to a non-cooperative equilibrium among the parties.[31] Law can function as the initial trigger which spurs the development or change in the contracting strategies of private parties,[32] so long as such governmental intervention can be reasonably calibrated to promote the desired change.[33]

Here, the institutional force of law is doing more than constraining individual agency, but also channeling contractual behavior by "opening up options for cooperative behavior which would not otherwise be feasible."[34]. Under the influence of law, private contracting parties might develop contracting strategies suitable to their circumstances. As the parties become acclimated to exchanging and disclosing information related to their true intentions and expectations for the venture, a cohesion can develop, harmonizing what might otherwise be a high level of tension amongst parties with conflicting goals and aspirations, had such matters not been disclosed.[35] Thus, as stated, the Article attempts to preliminarily develop and explore avenues to encourage strategic norm development, in the context of the nascent collaborative venture. The key here is that parties to the nascent venture need to be properly incentivized to more freely disclose private information to their prospective business partners, and the relevant legal regime must develop a framework that provides this incentive in a manner having its authority in legal precedent and existing doctrine.

The principal goal of any effort to endogenize norms of cooperation in the business venture context is to enhance the possibility of achieving the co-venture parties' joint welfare maximization (or, sometimes referred to as pareto efficiency or pareto optimal outcome in the game theoretic

---

31. *See* Scott, *supra* note 9, at 2021.

32. *See* Viktor Mayer-Schonberger, *Entrepreneurial Law*, OXFORD INTERNET INST. (April 2007) http://www.vmsweb.net/attachments/pdf/EntrepreneurialLaw.pdf (noting that "law can make outcomes more or less likely to happen."); *see also* Scott, *supra* note 9, at 2034 ("[L]egal rules ameliorate the problems of imperfect information."); Christine Jolls, Cass R. Sunstein, and Richard Thaler, *A Behavioral Approach To Law And Economics,* 50 STAN. L. REV. 1471, 1473 (1998) ("First, laws may be efficient solutions to the problems of organizing society. Such laws can be thought of as solutions to optimal contracting problems with all the affected parties at the table.").

33. *See* Jolls, *supra* note 32, at 1541.

34. *See* Arrighetti, *supra* note 19, at 192.

35. *See* Scott, *supra* note 9, at 2051 ("Specialized contractual relationships may require more varied and complex mechanisms than the current set of legal rules provide if contracting parties are to achieve an optimal resolution of their conflicting goals."); *see also* Jones, *supra* note 19, at 551 ("[C]ooperation provides a basis for enhanced cohesion among potentially conflicting groups and individuals."); J. William Callison & Allan W. Vestal, "*They've Created A Lamb With Mandibles Of Death": Secrecy, Disclosure, And Fiduciary Duties In Limited Liability Firms*, 76 IND. L.J. 271, 292 (2001) ("Unincorporated business organizations, through which autonomous persons associated in a limited community to carry on business for mutual advantage, are inherently tense.").

literature).[36] This goal is not certain to occur, of course, and not likely in every future scenario. But, if joint welfare maximization is a defined goal of the parties, then a strategy thought to reasonably achieve that goal must be implemented in the early stages of the business relationship. In developing the framework proposed by this Article, this project principally explores four (4) related questions:[37]

(1) Why are norms of cooperation of desirable legal value in the context of the nascent entrepreneurial venture?

(2) What are the judicial or legislative interests which justify involvement in nudging the nascent entrepreneurial venture towards processes which might endogenize norms of cooperation?

(3) What are the defining characteristics of the nascent entrepreneurial venture which law might place reliance on in order to support formulation of different legal rules and/or mechanisms than those applied in the context of more seasoned co-venture parties?

(4) How should law be formulated to promote norms of cooperation within the context of the nascent entrepreneurial venture; in what ways does the relevant state business organization law dictate how legal rights and duties can be assigned and enforced in order to promote the goals attendant to efforts to foster the development of norms of cooperation in the nascent venture?

---

36. Jules L. Coleman, *Efficiency, Utility And Wealth Maximization*, 8 HOFSTRA L. REV. 509, 512-13 (1979-1980) ("Resources are allocated in a Pareto-optimal fashion if and only if any further reallocation of them can enhance the welfare of one person only at the expense of another."). Another commentator provides an alternative definition of joint welfare maximization by making more direct reference to the need for cooperation in reaching an ideal contractual agreement:

> "Cooperation is defined here in terms of behavior which involves a good-faith effort to negotiate a mutually accommodating agreement…This need not necessarily take the form of a contract which is 'fair'; the issue here is simply whether the contract maximizes the parties' joint gains within the ex ante constraints of endowments and resources that they are operating under. Defection takes the form of behavior which amounts to an attempt by one side to impose its terms upon the other. This is modeled as an outcome under which, because one side benefits to some degree directly at the expense of the other and so reduces their incentives for cooperation, their joint product is not maximized."

Simon Deakin, *Legal Evolution: Integrating Economic and Systematic Approaches*, Legal Studies Research Paper Series, University of Cambridge Faculty of Law, Paper No. 44/2011, s. 2.2 (Sept. 2011) (available at: http://ssrn.com/abstract=1934738).

37. The general layout and tenor of these questions was patterned after a similar layout in an article by Jules L. Coleman. *See* Coleman, supra note 36, at 510.

1. *The Value of Norms Of Cooperation And The Governmental Interest*

Why norms of cooperation are valuable to nascent ventures, and why there should be judicial or legislative interest in supporting such norms are related matters (i.e. the first 2 questions above). The initial inquiry basically asks "Why cooperation? What is its importance or value to the success of the nascent entrepreneurial venture?" The second inquiry asks "Why should there be judicial or legislative interest in developing or enforcing strategies or methodologies designed to cultivate cooperation?" According to one commentator, "Cooperation, in the sense of owners of different inputs working together, is clearly a technical necessity for the process of production, whether it is organized within a single firm or in the form of relations between firms in a vertical supply chain."[38] So, among the reasons that certain more experienced co-venture parties may seek to implement strategies to cultivate a relational norm such as cooperation is because cooperation has strong production characteristics.[39]

The judicial or legislative interest in acknowledging the value of cooperation and in supporting the development of rules and methodologies which work to support its cultivation by private parties can be explained in terms of efficiency. However, efficiency as used in this context does not necessarily point to the normative goal of wealth maximization as the central interest of contracting parties engaged in an economic endeavor, as would be the case in the usual law & economics analysis.[40] But rather, here efficiency is approached from the vantage point of those venture objectives that the private parties believe important to their venture success; goals often other than (or, in addition to) wealth maximization. From a societal standpoint, these other goals are important if they result in the avoidance of negative externalities.[41] Recall, this Article theorizes that the increased disclosure of private information can serve as a catalyst promoting more

38. *See* Arrighetti, *supra* note 19.

39. *Id.*

40. *See* Braucher, *supra* note 9 at 707; *see also* Coleman, *supra* note 36, at 528; David Charney, *Nonlegal Sanctions In Commercial Relationships,* 104 HARV. L. REV. 373, 389 (1990) ("Posner has advanced the most strenuous claims for a . . . conception of wealth maximization as a normative principle.").

41. The term "negative externality" as used in this Article refers to the impact that inefficient investments have on society in terms of increased use of the courts to settle disputes and misallocation of resources that could have been diverted to other venture parties in a stronger position to make productive use of such resources. *Cf.* Luca Anderlini, Leonardo Felli, & Andrew Postlewaite, *Should Courts Always Enforce What Contracting Parties Write?* 7 REV. L. & ECON. 14, 20-21 (2011) (stating that inefficiencies arise because of the lack of disclosure of private information, and suggesting that by not enforcing certain contracts courts may enhance ex-ante efficiency by facilitating the disclosure of private information).

cooperative behaviors amongst nascent co-venture parties. On this view, the act of withholding information is deemed a non-cooperative action in that information asymmetries[42] cause co-venture parties to be more suspicious of each other, increasing the level of tension in the relationship. So, for example, if one venture party withholds information which does not reveal the true possibility that that venture party intends to act opportunistically and compete with the new venture, the other venture parties may make inefficient investments in giving of their intellectual capital, time, and money.[43] Legal decision-makers can view inefficient investments as prologue to increased interference from the courts to settle possible disputes amongst private parties. In addressing these types of situations, it may be efficient for courts or legislators to develop rules which discourage a party's undisclosed intention to compete and/or requires that party to state specifically their intent at the onset of the collaborative venture.[44]

Addressing the possible criticism that courts generally do not decide cases based on efficiency considerations[45], we can frame the court's justification for supporting the development of rules and methodologies which support the cultivation of cooperation in terms of social policy objectives. Again, viewing as non-cooperative any act of non-disclosure of private information that co-venture parties would find relevant to their business investment, and that such behavior creates an inefficiency for the reasons stated above. If the judiciary determines that certain norms (such as cooperation), which are developed by private parties to discourage the withholding of private information, have arisen from an incentive structure[46] which encourages societal advancement (long-run relations, enhancement of probabilities for nascent venture success, etc.) then there exists a public-good[47]. This public-good can justify judicial support of strategies or methodologies which promote cooperation amongst private parties.

---

42. *See* Robert E. Scott, *A Theory Of Self-Enforcing Indefinite Agreements*, 103 COLUM. L. REV. 1641, 1655 (2003) ("Asymmetric information results from private facts that either cannot be observed by the other party or cannot be verified to a third party.").

43. Ian Ayres & Robert Gertner, *Filling Gaps In Incomplete Contracts: An Economic Theory of Default Rules,* 99 YALE L.J. 87, 124 n. 165 (1989) ("Similarly, if strategic withholding of information explains why employers do not reveal to employees the true probability of future termination, employees may make inefficient investments in goods such as housing and human capital. In such situations it may be efficient for courts not only to make a default rule against termination without cause but also to require employers to state specifically that they wish to be able to fire for even arbitrary reasons.").

44. *Id.*

45. *See* Cooter, *supra* note 2, at 1690-91; Hillman, *supra* note 10, at 106, n.19.

46. *See* Cooter, *supra* note 2, at 1695-96.

47. *Id.*

2. *Laying Out The Characteristics Of the Nascent Venture(r)*

In continuing an effort to advance a framework upon which to legitimize governmental intervention into private ordering via the development of alternative legal methodologies or approaches to influence strategic norm development, the identification of the distinguishing characteristics of the nascent venture is of critical importance. Setting forth these characteristics functions as a signal to legal decision-makers that there is a basis for thinking about this type of venture in a different way than other ventures; maybe prompting legal decision-makers to be more receptive to legal innovation in this context.[48] This Article highlights two (2) initial areas of focus which other scholars and legal decision-makers might build upon to help differentiate the nascent venture from other collaborative ventures: (i) structural characteristics of the venture, and (ii) theories suggesting certain nascent venture party behavioral traits and potential responses to legal rules[49], implied from evidence drawn from scholars' work in the area of law and behavioral science.[50]

Regarding structural characteristics, the Article sets forth a hypothetical describing a typical nascent entrepreneurial venture.[51] The hypothetical provides a basic fact pattern serving as a point of reference against which to review and assess the ideas presented in the Article. In summary, the principle structural characteristics of the nascent venture emphasized in this Article are associated with the closely-held equity ownership of the venture entity (i.e. the venture is wholly-owned by a small number of venture parties) and the fact that all the owners of the venture entity are active in the management of the venture (i.e. there are no "passive" investors per se). As the Article discusses, the structural features of the nascent entrepreneurial venture have relevance in terms of the application of legal doctrine to address possible disputes or opportunistic conduct amongst the parties to the venture[52], most notably the nature and content of fiduciary duties, a principal focus of the Article and further discussed below.

---

48. *See* Scott, *supra* note 9, at 2038 (discussing how the state's control over the interpretation process might retard innovation).

49. *See infra* Part II.B.2.c.

50. *See generally* Russell B. Korobkin & Thomas S. Ulen, *Law and Behavioral Science: Removing The Rationality Assumption From Law And Economics*, 88 CAL. L. REV. 1051 (2000); Jolls, Sunstein, & Thaler, *supra* note 32; Russell Korobkin, *What Comes After Victory For Behavioral Law And Economics?*, 2011 U. ILL. L. REV. 1653; Donald C. Langvoort, *Behavioral Theories Of Judgment And Decision Making In Legal Scholarship: A Literature Review*, 51 VAND. L. REV. 1499 (1998).

51. *See infra* Part II.B.

52. *See infra* Part II.B.

As to behavioral characteristics, since our concern is with the development of norms of cooperation as a positive input into the productive capacity of the entrepreneurial venture, there is a societal interest at stake. When the import of legal inquiry reflects societal interests, legal decision-makers increasingly turn to interdisciplinary research.[53] The nascent entrepreneurial venture is circumscribed by social context, thus warranting some level of reliance on theories developed and empirically presented from the behavioral sciences. The inclusion of theories from this area helps to lay further groundwork for factors which might differentiate nascent venture parties from more seasoned co-venture parties. The behavioral characteristics covered in the Article, and which the Article, suggests merit more attention from legal decision-makers when considering the propriety of alternative legal methodologies are "bounded rationality"[54], generally, and certain of its component parts including the "availability heuristic"[55] and "overconfidence bias" (sometimes referred to as "overoptimism bias")[56]. A separate, though overlapping, area of concern is human behavior patterns in particular social contexts. It is suggested that the social context of the nascent venture party might impact decision-making in a way not always present in contexts where more experienced, repeat actors collaborate.

Do parties who must place higher degrees of reliance on bounded rationality when forming a business venture incur more errors in structuring their rights and obligations vis-à-vis new ventures? Since most folks learn from experience and repeated interactions in a given endeavor, the Article suggests that legal decision-makers consider whether parties in the nascent venture context act with greater reliance on bounded rationality than more seasoned strategic collaborators due to inexperience. This is particularly important if the strategic collaborations of nascent venture parties are more prone to impart negative externalities. Further, under a theory of freedom of contract, where parties are deemed to give their autonomous consent to obligation[57], under what contract theory does the legal decision-maker have license to consider the quality of that consent? If consent, due to certain

---

53. *See* George L. Priest, *The Growth Of Interdisciplinary Research And The Industrial Structure Of the Production Of Legal Ideas: A Reply To Judge Edwards*, 91 MICH. L. REV. 1929, 1936 (1993) ("In today's post realists world, the judge, scholar, and student must increasingly turn to interdisciplinary research – in economics, sociology, philosophy, or social theory – to understand best how the law can advance the interests of society.").

54. *See infra* Part II.B.2.

55. *See infra* Part II.B.2.

56. *See infra* Part II.B.2.

57. Kim Lane Scheppele & Jeremy Waldron, *Contractarian Methods In Political and Legal Evaluation*, 3 YALE J.L. HUMAN. 195 (2013); J. William Callison & Allan W. Vestal, *Contractarianism And Its Discontents: Reflections On Unincorporated Business Organization Law Reform*, 42 SUFFOLK U. L. REV. 493, 497 (2009).

weaknesses in individual decision-making is defective to some extent, legal decision-makers might consider some minimum measure of governmental intervention as welfare enhancing.

### 3. *The Nature Of Laws Supporting The Development Of Strategic Norms In The Nascent Venture*

What should law look like which has an objective of supporting the development of norms of cooperation within the context of the nascent venture? This Article posits that laws developed that encourage the disclosure of private information hold promise in nudging nascent venture parties towards more cooperative behaviors. But, what type of private information should be the focus of this effort? What type of private information should be more fully and specifically disclosed?

This Article seeks to be instructive by locating its analysis within a realistic institutional framework.[58] This method affords an "incremental approach to theory building,"[59] opening up the possibility that legal theorists and decision-makers might be more likely to identify points of connection in broader or different contexts. As such, the business entity through which the nascent venture is organized, as well as the choice of state law must be considered. This Article studies the nascent entrepreneurial venture as it would operate as a limited liability company (LLC) and under Delaware statutory law, thus implicating broad freedom of contract principles, backed by Delaware's fulsome embrace of the contractarian philosophy.[60] However, in this Article's view, certain of the characteristics of the nascent venture (as briefly highlighted above) suggest reasonable constraints on absolute freedom of contract in this context. To be sure, the freedom of contract afforded under Delaware is not free of constraint even in a broader context. Like every jurisdiction, Delaware recognizes implied terms (such as the implied covenant of good faith and fair dealing) that arise without having express basis in the precise contract terms that co-venture parties freely assent to.[61] This simply acknowledges the long standing principle that neither property rights nor contract rights are absolute, and that such rights are often circumscribed by policy considerations.[62] As to the choice of entity and choice of law, the discussion herein reflects the fact that the LLC is a

---

58. *See* Beerman, *supra* note 4, at 560; Edward L. Rubin, *The New Legal Process, The Synthesis of Discourse, And The Microanalysis of Institutions*, 109 HARV. L. REV. 1393, 1394 (1996).

59. *See* Korobkin & Ulen, *supra* note 50, at 1073.

60. *See infra* Parts II.B, IV.

61. *See* Bay Ctr. Apartments Owner, L.L.C. v. Emery Bay PKI, L.L.C., No. 3658-VCS, 2009 WL 1124451, at *8 (Del. Ch. Apr. 20, 2006).

62. *See* Linzer, *supra* note 9, at 189.

very popular vehicle for new ventures,[63] and that Delaware remains a leading state of formation for both mature companies and the type of nascent ventures discussed herein.[64]

Since increased disclosure of private information can result in higher transaction costs,[65] that especially must be considered when focusing on start-up ventures. Additionally, in a contractarian environment such as Delaware's, any such proposal must be mindful that in contractarian regimes most of the statutory provisions are enabling, meaning they only apply by default;[66] an approach having as one of its purposes the avoidance of increased transaction costs associated with more detailed and complete contractual agreements.[67] In order to facilitate private ordering in light of transaction costs, under contractarian regimes the law provides "off the rack"[68] rules which, in Delaware, the parties have the contractual freedom to adopt, modify, or supplant altogether.[69] Given the value placed on avoidance of mandatory contract provisions, or the necessity for complex and costly negotiations, in a contractarian regime the legal decision-maker must consider the justification for increased writing requirements.

In choosing the type of private information which law might nudge towards increased disclosure, this Article posits that more specific disclosure of information related to the parties' fiduciary duties is appropriate in the context of the nascent venture. While it is true that start-up ventures often have a heightened sensitivity to transaction costs, this Article is of the view that fuller and more specific explication of the parties' fiduciary rights and duties, or more specific waiver of such fiduciary rights and duties, does not impact transaction costs to a large extent because the kind of specificity called for is not too complex for parties to draft and express. The constraints attendant to transaction costs would be more strongly implicated if the parties were required to draft explicit provisions addressing contract modification mechanics, ex ante, for example, as that

---

63. *See infra* Part IV.A.

64. *See infra* Part IV.A.

65. *See* Ayres & Gertner, *supra* note 43, at 92-93 ("Contracts may be incomplete because the transaction costs of explicitly transacting for a given contingency are greater than the benefits. These transaction costs may include legal fees, negotiation costs, drafting and printing costs, the costs of researching the effects and probability of a contingency, and the costs of verifying whether a contingency occurred."); *see also supra* note 24.

66. *See* James McConvil & Mirko Bagaric, *Opting Out Of Shareholder Governance Rights: A New Perspective On Contractual Freedom In Australian Corporate Law*, 3 DEPAUL BUS. & COM. L.J. 255, 256 (2005).

67. *See* John C. Coffee, Jr., *The Mandatory/Enabling Balance In Corporate Law: An Essay On The Judicial Role*, 89 COLUM. L. REV. 1618 (1989).

68. Linzer, *supra* note 9, at 179.

69. *See* DEL. CODE ANN. tit. 6, § 18-1101(c) (West 2013).

entails greater complexity and drafting skill.[70] Other reasons addressed in the Article for choosing fiduciary duties as the category of private information made subject to increased disclosure are (i) the "cautionary"[71] and "evidentiary"[72] functions that greater explication of such duties provides, and (ii) the import that fiduciary issues have with respect to the "people" issues which are known to derail nascent ventures.[73]

Some commentators have suggested that one of the purposes of fiduciary duties is to operate as a constraint on selfish or opportunistic behavior, thereby encouraging cooperative behaviors.[74] Perhaps. Fiduciary duties, in the abstract, might be thought of as having these properties. But in the actual application and venture party realization of fiduciary duties, this Article takes exception to the effectiveness of fiduciary duties, as typically described, in constraining such behavior. Fiduciary duty obligations under the Delaware statutory regime (and the others that pattern their statute's after Delaware)[75] lack the level of salience that makes them adequate tools to police selfish or opportunistic behavior.[76] Increased explication of such duties, as suggested in this Article, is partly designed to offset this lack of salience.

Finally, in distinguishing the nascent venture by reference to its contractual environment, including its social context, this Article suggests that legal decision-makers have a basis for privileging certain facts when

---

70. *See* Barak Medina, *Renegotiation, 'Efficient Breach' And Adjustment: The Choice Of Remedy For Breach Of Contract As A Choice Of A Contract Modification Theory*, *available at* law.huki.ac.il/upload/renegotistion.doc (stating that since the transaction costs for drafting exit rules are trivial, that shouldn't be the justification for an incomplete contract. But, that drafting for modification mechanics, ex ante, implicates transaction costs to a larger extent.).

71. *See* Ayres & Gertner, *supra* note 43, at 123-24.

72. *Id.*

73. Joseph G. Hadzimas, Jr., Senior Lecturer, MIT Sloan Schools of Mgmt., *Considerations For Founders: Issues In Structuring Relationships Among Members Of The Founder Team*, MIT E-CLUB, http://web.mit.edu/e-club/hadzima/founders-memo.html (last visited Feb. 5, 2014).

74. *See* Sandra K. Miller, *What Fiduciary Duties Should Apply To The LLC Manager After More Than A Decade of Experimentation*?, 32 J. CORP. L. 566, 583 (1994) ("Professor Huang argues that fiduciary duty law is powerful because it harnesses emotions to comply with desirable psychological and social norms. He emphasizes that fiduciary law can have important rhetorical rules in shaping behavior.").

75. *See* JOHN M. CUNNINGHAM & VERNON R. PROCTOR, DRAFTING LIMITED LIABILITY COMPANY OPERATING AGREEMENTS 3 (3rd ed. 2013) (stating that at least 18 other U.S. LLC acts contain provisions based on or terminologically identical to the core freedom of contract provision in the Delaware statute).

76. *See* DiMatteo, *supra* note 13, at 729 ("[O]pportunism [occurs when] one party to a contract takes a competitive position that is contrary to the interest of the other parties to the contract or contrary to their common enterprise, such as in joint ventures, strategic alliances, and franchising.").

nascent venture parties pull them into the possible adjudication of venture matters.[77] For example, the "hypothetical bargaining" construct, heavily influenced by the law & economics field, calls for wealth maximization as the guiding principle in interpreting contracts and supplying terms. [78] However, where there is evidence that the parties intend a more intensive relational collaboration, and where there is an effort to support the development of strategic norms in that context, legal decision-makers might place more emphasis on aspects of the collaboration tending to lean less towards self interest, and more towards joint welfare goals. This effort impacts the interpretation of contracts and the supplying of terms[79] to fill gaps in contracts.

C. Contributions Made By Article; Section Outline

The author believes that this Article makes a significant contribution to the study of entrepreneurship by incorporating a contemporary, integrated analysis of legal and social factors which bear upon that institution and its specific contractual environment. The Article approaches the subject from the vantage point of supplying reasoned justification for potential state intervention, when legal decision-makers have good reason to believe such intervention is likely welfare-enhancing. In this case, the focus is on intervention which might spur norm development which enhances the success of the venture. But, even where scholars disagree with the particular prescriptive approach to this goal offered in this Article (i.e. greater explication of fiduciary duties amongst the venture parties), the author believes that the general analytical framework offered for state intervention presented in this Article forms a preliminary sketch that other scholars might find useful to their analysis in similar contexts. Thus located, this Article's broad applicability lies in its utility as an exploration into the process of legal evolution and jurisprudence, generally, but as applied in the real world context of the contractual relations of business parties in the entrepreneurial space, specifically.

Part II develops a simple nascent venture hypothetical against which to review and assess the points made in the Article. The hypothetical sets

---

77. *See* Jeffrey M. Lipshaw, *The Bewitchment of Intelligence: Language And Ex Post Illusions Of Intention*, 78 TEMP. L. REV. 99, 126 (2005) ("If no form of representation (narrative) is privileged, then isn't one story as good as another?" (citing Dennis M. Patterson, *Law's Pragmatism: Law As Practice & Narrative*, 76 VA. L. REV. 937, 995)).

78. *See* Coffee, *supra* note 67, at 1618.

79. *See* Braucher, *supra* note 9, at 708 ("Posner's assumption that generally people want wealth maximization in their interactions results in a unitary approach to both interpretation and questions of supplying terms. The approach calls for legal decision-makers to interpret or supply terms to maximize wealth.").

forth certain characteristics of the nascent venture, which help to distinguish it from other collaborative ventures. This is designed to serve as a foundation upon which legal decision-makers might form a basis for developing alternative approaches, more compatible in the nascent venture context. Specifically, this Part relates certain structural characteristics of the nascent venture to relevant precepts of Delaware LLC statutory law and Delaware's adherence to a contractarian philosophy. Further, this Part also introduces certain behavioral and psychological factors thought to impact the nascent venture(r) and their relevance to principle points presented in the Article. Included here is a discussion of the role of the "availability heuristic", "overconfidence bias", and the choices that legal decision-makers must make amongst alternative conceptions of contract when pursuing certain judicial goals.

Part IIII briefly expounds upon the general matter with which this Article is concerned: setting forth a suggested framework in which to approach innovation in law, in the nascent venture context, and with a view to strategic norm development. This Part briefly discusses the meaning of legal evolution, and the general importance and relevance of norms to law.

Part IV discusses the limited liability company (LLC), and its operation under Delaware's limited liability company statute, the Delaware Limited Liability Company Act (the "DLLC Act"). The information contained in this Part's important to the legal decision-maker in arriving at a more comprehensive understanding of the institutional arrangement, which is the focus of this Article. Included is a discussion of nexus-of-contracts theory (associated with contractarianism), and the philosophical divide that has existed in the Delaware courts regarding contractarianism and nexus-of-contracts theory.

Part V of the Article is a synthesis of the concepts covered in Parts II, III, and IV, and applies those concepts to the Article's hypothetical nascent venture, in an effort to illustrate the approach advocated by this Article.

## II. DESCRIPTION AND CHARACTERISTICS OF THE NASCENT ENTREPRENEURIAL VENTURE

### A. Developing A Basis For Formulation Of Alternative Methodologies

To create a pathway for judges or legislators to begin to get comfortable with legal innovation in a given institutional context, the scholar or legal decision-maker advocating a prescriptive approach must provide a basis on which to distinguish that institution from others where the current legal approaches and doctrine are deemed adequate. If the goal is to have the court justify the development of any new legal approach (such as law thought to encourage cultivation of norms of cooperation amongst private parties), then the court requires a reasoned approach for such

intervention.[80] What is needed is the attribution of a personality to the nascent venture that distinguishes it from (i) collaborations amongst more mature, established co-venture parties, and (ii) LLCs where there is no principal entrepreneurial purpose.[81] Further, as discussed later in this Article, development of a narrative distinguishing the nascent venture also assists judges in their gap-filling role,[82] as they determine the relative significance of various facts in the context of such ventures,[83] as might be required in instances of adjudication.

B. A Sketch Of An Hypothetical LLC Entrepreneurial Venture

While the hypothetical developed in this Section is not uncommon, it is conceded that there can be myriad fact patterns in which parties join together to collaborate in a new venture. The purpose of this hypothetical is to highlight a scenario, variations of which are encountered from time to time, and to use that as a basis for constructing a contractual prototype.[84]

**Name of Company and Purpose**: TS7 Organ Synergies LLC (the "Company") was formed in the State of Delaware, and is currently comprised of four (4) equity members (the "*Members*") (see below). The Company has been in existence just under 4 months now, and was created to house a potential patent related to a prescription drug which shows promise in lengthening the survival period of patients who have undergone a lung transplant. The Members have filed a provisional patent for a drug

---

80. *See* Rubin, *supra* note 2, at 1890-91.

81. *See* DEL. CODE ANN. tit. 6, § 18-106(a) (West 2010) ("A limited liability company may carry on any lawful business, purpose or activity, whether or not for profit.."); J. William Callison, *Nine Bean-Rows LLLC: Using The Limited Liability Company To Hold Vacation Homes And Other Personal-Use Property*, 38 WM. MITCHELL L. REV. 592, 592-93 (2011). Callison notes that LLCs are used as subsidiaries for non-profit, charitable entities, by individuals and families for property holding purposes, vacation homes, etc. In my view, the risks inherent in the LLC entrepreneurial contract are of a more precarious nature than the risks associated with LLCs in other, non-entrepreneurial contexts.

82. *See* Hillman, *supra* note 10, at 116 ("[T]he inevitability of changed circumstances may make gap filling unavoidable."); Robert E. Scott, *The Case For Formalism In Relational Contract*, 94 NW. U. L. REV. 847 (2000) ("Complete contracts (to the extent they exist in the real world) are rarely, if ever breached since by definition the payoffs for every relevant action and the corresponding sanctions for nonperformance are prescribed in the contract."); Scott, *supra* note 42, at 1641 ("All contracts are incomplete."); Braucher, *supra* note 9, at 712 ("[P]arties are inevitably silent on many matters, and interpretation thus shades over into supplying terms.").

83. Braucher, *supra* note 9, at 726 ("Whether a question of interpretation involves formation or content of obligation, the reasonableness of one party's meaning depends on context. Selection of what is significant in the context gives the court a regulatory role.").

84. *See* Scott, *supra* note 9, at 2036, n. 92 ("Accumulated experiences are thus very important in shaping customary contractual prototypes.").

they believe shows promise in lengthening the average life span of lung transplant patients by 3 years.[85]

**Choice of Delaware and the LLC Form:** The members did not give strong consideration to any particular business entity through which to operate the Company, but they had heard that the limited liability company is a popular choice.[86] The members chose Delaware to form the Company because they were informed by their patent attorney that many other start-ups choose Delaware, and also they want any future financiers to be comfortable with the law governing their operation.[87]

**Members and Management:** The Members and Officers of the Company are as follows:

| Member Type | Equity Share | Officers |
|---|---|---|
| Individual Member A | 23.0% | Manager |
| Individual Member B | 23.0% | |
| Individual Member C | 23.0% | |
| Corporate Member (c-corp) | 31.0% | Manager |

Additional information on the Members:

The Individual Members range in age from 29 to 58 years old. While forming this new venture, the Members remained active in their pre-venture occupations, which include (i) salesperson for a specialty pharmacy, (ii) a biomedical researcher with her own small lab company, employing 3 full time employees, and (iii) a principal/founder of a small, but well known discount pharmacy. The Corporate Member is wholly owned by one individual (along with his family trusts), and is a medium sized pharmaceutical distributor on the East Coast, with 27 employees. Also, the Corporate Member received a 31.0% equity share in exchange for a cash contribution of $650,000 (the largest among the Members).

Prior to starting the Company, although the Members knew each other through various trade associations and professional networks, they had never transacted together in a business relationship. Only the Corporate Member had modest experience in executing transactions of the type represented by the current venture.

---

85. *See* Erin Allday, *Lung Transplant Patients Face Tough Odds*, S.F. CHRONICLE, Oct. 31, 2012, http://www.sfgate.com/health/article/Lung-transplant-patients-face-tough-odds-3998899.php.

86. *See infra* Part IV.

87. *See* Miller, *supra* note 74, at 566 (noting that the State of Delaware has long been considered the most important jurisdiction in developing business entity laws); David Rosenberg, *Making Sense of Good Faith In Delaware Corporate Fiduciary Law: A Contractarian Approach*, 29 DEL. J. CORP. L. 491, 492 (2004) (noting that "since half of all large corporations in the U.S. are governed by Delaware law, commentators look to the courts of Delaware for guidance").

**LLC Operating Agreement**: For a short period (4 months), the Company operated without a formal, written operating agreement. But they now desire a simple agreement and are planning to hire a general corporate lawyer and have him quickly put together a simple document in the interest of time.

**Manager Positions**: As to election of Managers, the Individual Members had to agree to the Corporate Member's request to have a permanent representative in one of the two (2) Manager positions in the Company. The other Manager position would simply rotate each year among the Individual Members in an "equitable manner." The Members felt that all the Members should participate in decision-making to some extent. To that end, Managers will only have authority to make decisions concerning miniscule day to day activities of the Company, but major decisions, like financing, sale of the Company, etc., would be subject to a vote of the Members, based on the Members' equity interests in the Company.

1. *Structural Characteristics And Fiduciary Duties, Generally.*

In general, the structural features of the nascent entrepreneurial venture have relevance in terms of the application of legal doctrine to address possible disputes or opportunistic behavior amongst the parties to the venture, most notably, the operation of fiduciary duties. Focusing on fiduciary duties, such duties are often thought to address the abuse by a venture party of discretionary authority delegated to such party.[88] The delegation of certain powers or authority to a party or parties by her fellow co-venturers is generally to be used in furtherance of a business purpose, and not in furtherance of one's self-interest.[89] The policy supporting this view of fiduciary duties is plainly evident in a situation like the trust & estate area where the designated trustee is charged with managing assets for the beneficiary; or in the limited partnership setting where the general partner is entrusted with the limited partner funds and decision-making for

88. Coffee, *supra* note 67 at 1621-22 (stating that in the corporate context that parties contract in the shadow of the law knowing that courts will be the arbiter to determine how powers granted to management are exercised in unforeseen circumstances); *see* Jones, *supra* note 19, at 569 ("Societal advancement may be measured by the extent to which discretionary authority is delegated with a fair degree of confidence that it will be exercised with fidelity to the purpose of the delegation.")

89. Coffee, *supra* note 67 at 1621 ("In short, because long-term relational contracting is necessarily incomplete, the court's role becomes that of preventing one party from exercising powers delegated to it for the mutual benefit of all shareholders for purely self-interested ends.")

(usually) passive partners who have no management authority[90]; or, in the corporation setting where the directors of the corporation are entrusted with a high degree of management authority, and who are generally separate from the shareholders, senior management and employees of the corporation.[91]

However, in the situation where the management, ownership and employment relationships are intertwined amongst a small number of partners or members, neither of whom is given a broad breadth of discretionary authority, how should legal decision-makers think about the purpose of fiduciary duties in that context? Even if a common justification for fiduciary duties (i.e. to police the abuse of discretionary powers) has a weaker premise, the parties in arrangements similar to our nascent venture still would expect obligations from their co-venturers approximating typical fiduciary duties, together with equitable remedies in the event of breach. In our hypothetical, the co-venture parties do plan to provide for "Manager" positions, and they all expect to serve as Manager at some point in time. But, as the hypothetical indicates, they do not intend to give any one Manager a wide breadth of authority, but rather desire that everyone be given a right of participation in the title role that is designated as Manager. This approach with respect to the Manager arrangement does not need to be a permanent feature of the venture, but serves a beneficial purpose at a point in time in the life cycle of the venture. When the parties more comfortably settle into their particular roles within the organization, they might alter this arrangement. But, it will take a level of trust and cooperation to get to that point. Here, when legal decision-makers have occasion to examine this arrangement (maybe in the event of a dispute), it is important to incorporate the internal perspective of those subject to the arrangement. What might be gleaned from aspects of this hypothetical is that the parties have chosen to emphasize participation rights over the assignment of individual express authority to direct the most important affairs of the Company. This leans toward a more relational intent and purpose to the parties' venture arrangement.[92] Taking an analytical cue from historians, anthropologists, and others in the social sciences, for example, often there is the distinction made between the perspective of the emic (or insiders' view) as opposed to

---

90. *See* LARRY E. RIBSTEIN & ROBERT R. KEATINGE, RIBSTEIN AND KEATINGE ON LIMITED LIABILITY COMPANIES 520 (2nd ed. 2013); Feeley v. NHAOCG, L.L.C., 62 A.3d 649, 662-63 (Del. Ch. 2012).

91. *See* J. William Callison, *Venture Capital And Corporate Governance: Evolving The Limited Liability Company To Finance The Entrepreneurial Business*, 26 J. CORP. L. 97, 101 (2000) ("Thus, the corporation can be considered as a form providing a differentiated management and control structure in which shareholders elect directors and participate in certain fundamental decisions; directors establish policy, select officers, and perform monitoring functions; and officers implement policy and act as the firm's agents.").

92. *See supra* note 9.

the etic (or the outsiders' view).[93] Studying both perspectives helps to arrive at the most ideal approach. When formulating legal policy, or even in interpreting a contract, an effort to understand from the vantage point of the emic can be influential in how the facts are ordered, and in what outcome to ordain in the event of a dispute.[94]

In jurisdictions (like Delaware) which purport to allow complete waivers of fiduciary duty in the LLC context (and in the limited partnership context), to what doctrine should parties in the nascent venture turn when they are entering a trust relationship and are relying on the reasonable cooperation of their fellow co-venturers, even if that reliance is not expressly set forth in words in the written LLC operating agreement? These are issues which should be considered by judges and other legal decision-makers when evolving doctrine in order to spur endogenous change (norm development, for example) by private parties in their social arrangements, including in the nascent venture context.

a. Specific Structural Arrangement and Relevance To Delaware Law

When studying an institutional arrangement and how prescriptive measures might be integrated into such an arrangement, scholars and legal decision-makers must expressly consider how the arrangement functions within the precepts of the governing law. In the case of this Article, we must consider more specifically how the nascent entrepreneurial venture is structured, and how that structure welds with Delaware's contractarian philosophy, applicable to LLC's.

The principal structural characteristics of the nascent venture which are emphasized in this Article, and which define the hypothetical above are: (1) A closely-held business entity (i.e. closely-held in that there are a small number of owners of equity in the business); (2) the main purpose of the venture, broadly defined, is the commercialization[95] of a new product or service; (3) the owner/managers of the venture have no previous (or very limited) prior business dealings with each other (i.e. contract law's "course of dealing" concept is not a factor[96]); (4) all the equity owners of the

93. ANNA GREEN & KATHLEEN TROUP, THE HOUSES OF HISTORY – A CRITICAL READER IN TWENTIETH CENTURY HISTORY AND THEORY 177 ("It is, perhaps, this enduring problem of perspective, between that of the emic (the insiders viewpoint) as opposed to the etic (the outsiders') that has led to the development of a postcolonial history.").

94. Lipshaw, *supra* note 77, at 142.

95. *See* Smith & Ueda, *supra* note 6, at 357.

96. *See* DiMatteo, *supra* note 13, at 737 ("The Restatement (SECOND) of Contracts defines "course of dealing" as a sequence of previous conduct between the parties to an agreement which is . . . to be regarded as establishing a common basis of understanding for interpreting their expressions and conduct.").

business are, to a more or less equal extent involved in management of the enterprise (i.e. the owners are not "passive"; they all participate in making critical management decisions, with only very modest higher delegations of authority for day-to-day functions to whomever is serving as a Manager); and (5) with minor exceptions (in the case of the Corporate Member in our hypothetical), the co-venture parties do not have wide experience with organizing and implementing a formal business venture with fellow co-venturers.

Of course, the characteristic numbered "5" above (and, maybe to a lesser extent, the characteristic numbered "4" above) is more subjective than the first few factors, as it bears on the sophistication of the parties to the nascent venture. But, it is suggested that courts have developed a high degree of comfort in gauging levels of sophistication of parties to business ventures. Certainly, in judicial opinions in Delaware at least, courts have shown faint reluctance to proclaim certain venture parties as "sophisticated."[97] Also, albeit in an entirely different context, every jurisdiction has adopted the *Williamson* test, which includes a prong that looks to the level of experience of a business party.[98] If a fact-intensive inquiry becomes necessary, then legal decision-makers have shown a degree of competence in that area.

The above characteristics typify closely-held business ventures. Regarding this, we can analogize to an observation made by Professor Steven Hobbs with respect to the closely-held corporation:

> "The principle distinguishing feature of the closely-held corporation is a small number of shareholders, though in all likelihood the firm will also be one of relatively modest economic scope (whether measured by revenues, by assets, or on any other scale), and generally (though by no means always) the people owning a substantial portion of the total shares will occupy the top managerial positions or will be involved in a meaningful way in the selection and monitoring of the people who do occupy those positions as well as in the formulation of corporate strategies and polices."[99]

---

97. *See In re* ALH Holdings, L.L.C., 675 F. Supp. 2d 462, 477 (D. Del. 2009); Kuroda v. SPJS Holdings, L.L.C., No 4030-CC, 2010 WL 925853, at *1 (Del. Chan. Mar. 16, 2010); Vila v. BVWebties L.L.C., No. 4308-VCS, 2010 WL 3866098, at *8 (Del. Ch. Oct. 1, 2010); Related Westpac L.L.C. v. JER Snowmass L.L.C., No. 5001-VCS, 2010 WL2929708, at *8 n.33 (Del. Chan. Jul. 23, 2010) (citing Personnel Decisions Inc. v. Bus. Planning Sys., Inc., No. 3213-VCS, 2008 WL 1932404, at *6 (Del. Chan. May 5, 2008)) ("Delaware is a freedom of contract state, with a policy of enforcing the voluntary agreements of sophisticated parties in commerce.").

98. *See* Williamson v. Tucker, 645 F.2d 404 (5th Cir. 1981). The *Williamson* test is applied to determine if general partner or limited liability company interests are securities. *See also* ROBERT J. MCGAUGHEY, WHEN LLC INTERESTS ARE SECURITIES 14 (2012) ("The second prong of the Williamson Test looks to the inexperience of the partner or some other factor which renders the partner unable to meaningfully exercise his partnership powers.").

99. Hobbs, *supra* note 8, at 265 n.60.

A quick word on one additional feature of the hypothetical presented above. The nascent venture represented by this hypothetical does not consider the inclusion of a venture capital financier at the onset of the venture. The presence of a venture capitalist potentially could alter the dynamic represented by the nascent venture hypothetical. In turn, the legal decision-maker possibly might be required to incorporate the inclusion of a venture capitalist in developing an approach designed to effect norm development within the venture. By limiting this Article's analysis to situations where the influence of venture capital financing is not a factor, an attempt is made to present the nascent venture closer to its infancy, and to negate the impact that any further macro-sociological theories might bear on the venture parties' private bargaining.[100]

In Part IV, the Article discusses Delaware's contractarian philosophy at some length,[101] the theory which underlies Delaware's LLC statute, the Delaware Limited Liability Company Act (the "DLLC Act").[102] Briefly here, it is helpful to introduce an analysis of the structural characteristics of the nascent venture in light of policy supporting the contractarian theory. Where (as supported in this Article) legal decision-makers seek to encourage increased disclosure of private information, if the contractarian theory in any way cuts against that objective, the legal decision-maker should attempt to reconcile that objective with policy and proffered judicial justification for the contractarian approach.

Contractarianism places a high value on the non-intervention of government into the private ordering of autonomous parties who freely give of their consent to obligation.[103] The imposition of fiduciary duties is thought to impede on the private parties' bargain. This is the essence of the "freedom of contract" that is forthrightly set forth in the Delaware LLC statute.[104] If the contractarian justification is weaker in the nascent venture context, then there is a potential opening for intervention by the State in that context for appropriate purposes. Stated differently, we should examine whether the nascent venture comfortably fits within policy which informs the Delaware statute governing LLC's. The Delaware Supreme Court's Chief Justice Steele, a leading proponent of the contractarian approach, in two (2) law review articles based a large part of his argument for the contractarian approach on the assumption that the parties are "passive"

---

100. Bebchuk & Roe, *supra* note 26, at 158 (discussing how certain corporate players might comprise influential interest groups).

101. *See infra* Part IV.B-C.

102. *See infra* Part IV.A.

103. *See* Miller, supra note 74, at 569.

104. *See* DLLC Act, DEL. CODE ANN. tit. 6, §§ 18-1101(b)-(c).

investors,[105] and that the parties are "sophisticated."[106] Regarding "passive" investors, Chief Justice Steele assumes that such parties have a heightened interest in negotiating a neat package of rights since they are not given management authority in the enterprise.[107] This is interesting, because by implication it seems that Chief Justice Steele is saying that venture parties who are *not* passive (as in our hypothetical) do not need to negotiate strong contractual rights because they possess management authority. Is having management authority a substitute for strong contractual rights? Where management authority is abused, and there is not a well detailed and heavily negotiated contract (as contractarianism provides "off the rack" rules for purposes of lowering transaction costs associated with heavily negotiated contracts), to what doctrine should parties turn in the closely-held venture context where trust is assumed? Maybe what is required is a strong presumption that fiduciary duties attach unless clearly and specifically eliminated or modified. Certainly, parties to the nascent venture can be both passive and sophisticated, but those assumptions are more commonly applicable in the limited partnership context. Limited partners are more likely to be passive investors by definition, because if they participate in management they could be subject to liability, unlike the case with LLC members.[108] Further, as noted by Ribstein and Keatinge, the LLC is becoming a "default" entity that invites use by unsophisticated parties, while limited partnerships are generally used by more sophisticated parties.[109]

To the extent that Chief Justice Steele's promotion of a contractarian approach depends on "passive" parties and "sophisticated" parties, then maybe legal decision-makers should examine whether such a philosophy should be followed in the more typical nascent entrepreneurial context where parties are not always situated in line with those assumptions. One might read Chief Justice Steele's defense of contractarianism as being applicable to LLC structures which more closely resemble limited partnership structures.[110] But, the DLLC Act does not distinguish nascent venture LLC structures from more complex or corporate-type LLC

---

105. *See* Myron T. Steele, *Judicial Scrutiny of Fiduciary Duties In Delaware Limited Partnerships and Limited Liability Companies*, 32 DEL. J. CORP. L. 1, 9-10 (2007).

106. *See id.* at 6; *see also* Myron T. Steele, *Freedom of Contract And Default Contractual Duties In Delaware Limited Partnerships And Limited Liability Companies*, 46 AM. BUS. L.J. 221, 237 (2009).

107. *See* Steele, *supra* note 105, at 9-10.

108. *See* RIBSTEIN & KEATINGE, *supra* note 90, at 520.

109. *See id.* at 462, 511.

110. Since LLC's have characteristics of both partnerships and corporations, an LLC governance structure can be flexible. An LLC can have a Board of Directors (or Board of Managers), similar to a corporation, or it can be structured more in line with simple general partnerships. *See generally,* Callison, *supra* note 91.

structures. However, as discussed later in Part IV of this Article, the approach taken by Chief Justice Steel in *Cantor*,[111] is applicable to the nascent venture party in that it seems to place strong emphasis on context (or contractual environment of the parties). Departing somewhat from the passive/sophisticated parties characterization, in *Cantor*, Chief Justice Steele appeared not to place his analysis on the relative sophistication of the parties (though they were quite sophisticated), but rather based his decision on the business context, determining that the parties were engaged in a collaborative undertaking, justifying the imposition of enhanced duties.[112] It is worth emphasizing: In *Cantor*, even the venture parties who had no management authority (the limited partners) were deemed fiduciaries because of the social/business context in which they contracted. But it is possible that Cantor was an outlier decision. Other jurisdictions, taking note of Delaware's usual approach (where parties with no management authority are deemed not to have fiduciary duties), have contrasted certain of their decisions with the presumed approach that Delaware would take. For example, the Supreme Court of Rhode Island stated, "But our Supreme Court, unlike Delaware, has recognized that shareholders in a closely-held corporation may owe to each other a duty of utmost care and loyalty – a duty similar to that pledged by partners in a partnership."[113] That case involved an LLC where the sole manager argued that the complaint by members in the LLC that he breached his fiduciary duties should fail because the operating agreement permitted transactions between the LLC and a company he owned separately.[114] But the court determined that a heightened duty was owed due to the fact that the venture only involved only a few members, and thus practically all members were intimately involved in management.[115] The court reasoned that due to the heightened duty, the reasonable interpretation of the clause in the LLC agreement which purported to permit self-dealing was valid only as to the initial transactions which established the venture between the parties, and did not dilute the on-going duty owed by the manager.[116] The Rhode Island court placed a limit on the reach of freedom of contract by requiring more specificity regarding the self-dealing provisions of the LLC operating agreement. If, as in *Cantor*, legal decision-makers in a contractarian jurisdiction can interpret relational context as the justification for imposition

---

111. *See* Cantor Fitzgerald, L.P. v. Cantor, No. 16297, 2000 WL 307370 (Del. Ch. 2000).

112. *Id.* at *22.

113. Marsh v. Billington Farms, L.L.C., No. 04-3123, 2006 WL 255591, at *5. (R.I. Sup. Ct. Aug. 31, 2006).

114. *Id.* at *4.

115. *Id.* at *5.

116. *Id.* at *7.

of certain duties, this suggests that government intervention into private ordering based on policy objectives can sometimes outweigh the contractarian norm of non-intervention.

b. The Nascent Venture Possesses The Main Attributes Of Collaborative Agreements

As discussed in the Introduction, and to be further elaborated on in Part III of the Article, more established companies are increasingly co-venturing together by structuring their initial collaborations to emphasize the relational aspects of the venture. They believe that that approach holds greater promise of venture success.[117] By adopting relational contracting techniques, they attempt to reduce the level of uncertainty in their collaboration, seeking greater confidence that their fellow co-venturers will be cooperative in the face of unforeseen issues, ex post.[118]

Like more established parties, parties to the nascent venture seek to leverage the capabilities and skill sets of their co-partners in an effort to exploit entrepreneurial opportunities[119] Also, similar to the strategic alliances of more established parties, in order to fulfill the collaborative purpose of the venture, the main objective of parties to the nascent venture ought to be "minimizing conflicts of interest, continuing to align interests, and preventing opportunistic behavior by of one of the collaborating parties."[120] A contracting process allowing for the structural integration of relational norms is central to this objective.

According to one commentator, collaborative agreements have four (4) main attributes: (1) shared responsibility; (2) maintenance of individual identities; (3) continual transfer of resources; and (4) indivisibility of product.[121] Each of these attributes (with the arguable exception of the second attribute) is present in the nascent entrepreneurial venture. As this listing of attributes is primarily geared towards larger, more established companies choosing to collaborate together, the second attribute is more applicable in that context than in the nascent venture context. Established companies that collaborate together can structure their alliances with the advantage of a fallback safety position of continuing their company's pre-collaboration existence and operations in the event the new venture fails. This is also a function of the fact that more established companies may have responsibilities to other employees, managers or investors backing their operations, factors not as frequently present in the nascent venture

117. *See infra* Part III.B.
118. *See* Gilson, *supra* note 17, at 1382, 1385.
119. *See* Hobbs, *supra* note 8, at 265.
120. *See* DiMatteo, *supra* note 13, at 755.
121. *See* Salbu, *supra* note 11, at 398.

context.[122] When parties join together in the nascent venture, often they put all their hopes and aspirations into the eventual success of the new venture. Often, nascent venture parties are more exposed to loss than parties to larger, more complex ventures, perhaps warranting a greater judicial willingness to monitor nascent venture arrangements.[123] One commentator suggests that the usual reasons for viewing venture parties in closely held settings as being more exposed to risk include "…not only the absence of a liquid market for their shares, but also the factor of asset specificity."[124] Asset specificity in the nascent venture context refers to the human assets which are invested in such ventures and which "cannot be redeployed costlessly because they are to a degree firm-specific."[125]

One very important characteristic that parties to the nascent venture share with more established co-venture parties is the uncertainty due to the high likelihood that the parties to such alliances are potential competitors.[126] Absent an effort to firmly engrain relational norms into the contracting process in its earliest stages, the co-venture is threatened by partners staking out defensive positions.[127] Again, many experienced co-venturers are on guard for the potential negative impact of this on their alliances, and they seek to employ strategic methods aimed at reducing risks here.

2. *Behavioral/Psychological Considerations*

a. Relevance of Behavioral/Psychological Characteristics

Because this Article is concerned with the development of norms of cooperation as a positive input into the productive capacity of the nascent venture, there is a societal interest at stake. When the import of legal inquiry reflects societal interests, legal decision-makers increasingly turn to interdisciplinary research.[128] The nascent venture is circumscribed by social context, thus warranting some level of reliance on theories developed and empirically presented from the behavioral sciences.[129] Also, since laws are

122. The second attribute of collaborative agreements listed above (i.e. maintenance of individual identities) seems directly related to the point here about more established companies having separate responsibilities to other employees, managers, etc.

123. Coffee, *supra* note 67, at 1690.

124. *Id.* at 1690 n. 284.

125. *Id.*

126. *See* DiMatteo, *supra* note 13, at 755.

127. *Id*. ("As competitors, they will be sensitive to turning over competitive advantages to assist the alliance . . .").

128. *See supra* note 53.

129. *See* Russell Korobkin, *What Comes After Victory For Behavioral Law And Economics*?, 2011 U. ILL. L. REV. 1653, 1656 ("There is a sharply declining marginal benefit to be gained by continuing to pursue the debate between behavioralists – that is, proponents of incorporating insights previously limited to the discipline of psychology into the economic

generally geared towards specific portions of the population,[130] it is instructive to better understand any distinctive behavioral characteristics which might, through further experimental study, be associated with parties to the nascent venture. The effort here assists the scholar and legal decision-maker with drawing a fuller picture of the nascent venture to use in developing alternative methodologies and approaches suitable to that context. Although more research into the human psychology of parties to start-up ventures is called for, there is broad data which we can use as analytical tools in beginning to bring greater clarity to the behavioral characteristics of the nascent venturer.[131]

b. Legal Choices To Be Made: Conceptions Of Contract; Policy Objectives

When parties to the nascent venture form a contract governing their relations with each other, they necessarily pull in a set of rules and theories which legal decision-makers rely on to interpret their contract. In an effort to construct a framework that supports the cultivation of strategic norms by private parties, legal decision-makers must confront directly conceptions of contract which lean either towards individualist visions[132] of contract, or alternative visions of contract which emphasize values in addition to freedom of contract principles.

In this Article's view, an inquiry into behavioral characteristics of private venture parties for the purpose of developing a framework which supports endogenous change by these parties, presupposes some link between these characteristics and the centrality of consent as a basis for enforcement of obligations or rights. The pure autonomy (or liberal) conception of contract[133] is not a good fit if the legal decision-maker questions the quality of consent given by a venture party. If, under the autonomy conception of contract, individuals are thought to be the best judges of what will promote their own welfare,[134] then to question that judgment based on human psychological factors that might negatively impact individual decision-making moves away from pure freedom of

---

analysis of legal rules and institutions – and the defenders of the traditional faith in individual optimization as a core analytical assumption of legal analysis. Not everyone has been won over of course, but enough have to justify granting amnesty to the captured and politely ignoring the unreconstructed.").

130. *See* Korobkin & Ulen, *supra* note 50, at 1072.

131. *See infra* Part II.B.2.

132. *See* Scheppele & Waldron, *supra* note 57, at 199; David Charny, *Nonlegal Sanctions In Commercial Relationships*, 104 HARV. L. REV. 373, 380-91; Callison & Vestal, *supra* note 57.

133. Scheppele & Waldron, *supra* note 57, at 199; Charny, *supra* note 132, at 380-86.

134. *See* Miller, *supra* note 74, at 569.

contract. According to one commentator, under "[a]utonomy – or rights based formulations of contract law, the promisor is legally obligated to keep his promise because he has intentionally invoked a convention whose function it is to give grounds – for another to expect the promised performance."[135] Here, the quality of consent is generally unchallenged, excepting pursuant to doctrines such as unconscionability or duress, which police the limits of 'fair' bargain.[136] However, liberalism, which is associated with the autonomy conception of contract, has gradually recognized the need for some level of State intervention into private ordering.[137]

Judicial acknowledgement of a role for cooperation within the context of the nascent venture has a couple of implications. First, it challenges "the neoclassical economic view of contracts" as exchange based, rather than more relationship based.[138] Second, acknowledging a role for cooperation within the nascent venture suggests that the venture parties may seek goals in their collaboration other than (or, in addition to) wealth maximization,[139] the primary goal of venture parties as theorized by law and economics scholars.[140] The goal of wealth maximization is closely allied with Delaware's contractarian philosophy, which underlies Delaware's approach to LLC law. In contractarian thought, the business entity is regarded as a nexus of contractual relationships, rather than a separate legal entity created by the State.[141] Thus, contractarian theory focuses on the economic relationships between contracting parties.[142] Stated another way, contractarianism represents an economic analysis of business law. Since the business entity merely represents a contractual relationship, the parties that form the entity and the relationships created within the business entity "can be freely structured under the freedom of contract rationale."[143] As such,

---

135. *See* Charny, *supra* note 132, at 381-82.

136. *See* Clare Dalton, *An Essay In The Deconstruction Of Contract Doctrine*, 94 YALE L.J. 997, 1024 (1985).

137. *See* Linzer, *supra* note 9, at 146; TONY JUDT &TIMOTHY SNYDER, THINKING THE TWENTIETH CENTURY 92 (2012) (Interviewer: "Let me take a stab at epistemologically separating liberalism from Marxism. Liberalism starts with optimistic assumptions about human nature, but in practice it's easy to slide down a slope, where one learns that one should be . . . more pessimistic, which requires a bit more intervention, a bit more condescension, a bit more elitism, and so on. And that is, in fact, the history of liberalism, at least to the new liberalism of the early twentieth century with its acceptance of state intervention.").

138. *See* Braucher, *supra* note 9, at 708.

139. *Id.* at 707.

140. *See* Rubin, *supra* note 2, at 1893.

141. *See* DiMatteo, *supra* note 13, at 779-89; Miller, *supra* note 86, at 580; McConvil & Bagaric, *supra* note 65, at 256.

142. *See* Miller, *supra* note 74, at 580.

143. *See* DiMatteo, *supra* note 13, at 784-85.

contractarianism is consistent with the autonomy conception of contract and can be summarized as championing "the ability of autonomous parties at arms' length to give their unbridled consent to arrangements whose goal is their own wealth maximization."[144]

If the pure autonomy conception of contract does not represent a good fit for scholars and legal decision-makers seeking methodologies or approaches which might influence the cultivation of norms of cooperation, we must turn to alternative conceptions of contract. Scholars and legal decision-makers focused on this area would base their approaches on some version of either communitarianism, instrumentalism, or both as alternative conceptions of contract.[145] Importantly though, the idea of consent must continue to play a major role in the analysis in order that the approaches taken are deemed legitimate.[146] Even under alternative conceptions of contract, consent does not disappear, but is adjusted to fit the aims of the scholar or legal decision-maker. For example, Richard Posner, a leading proponent of the law and economics approach to contracts, advocates wealth maximization as the principle goal of contracting parties.[147] This goes beyond the pure autonomy conception of contract because it emphasizes something other than mere freedom of contract, standing alone, as a basis of contract interpretation. Posner's approach is rooted in instrumentalism as a conception of contract. Law and economics adherents find a route to consent (i.e. hypothetical bargaining)[148] which advances their aims of wealth maximization as the normative goal of contracting parties. As defined by one commentator, "Instrumentalism, as a normative theory of law, takes as the community's goal some version of wealth maximization, avoidance of social waste, minimization of transaction costs, or the like."[149] With respect to interpretation of contracts, and supplying terms to fill gaps in contracts,[150] law and economics proponents rely on this form of implied consent,[151] again assuming that people only seek wealth maximization in their relationships.[152] This results in a single approach to both interpretation and questions of supplying terms to contracts.[153]

---

144. *See* J. William Callison and Allan W. Vestal, *Contractarianism And Its Discontents: Reflection On Unincorporated Business Organization Law Reform*, 42 SUFFOLK U.L. REV. 493, 497 (2009).

145. *See* Charny, *supra* note 132, at 379-91.

146. *See* Scheppele & Waldron, *supra* note 57, at 196-97.

147. *See* Charny, *supra* note 132, at 389 n.52.

148. *See* Coffee, *supra* note 67, at 1623 ("Proponents of hypothetical bargaining assume that rational parties would agree ex ante on whatever provision maximized value, even if the resulting gains were to be unequally distributed.").

149. *See* Charny, *supra* note 132, at 389-90.

150. *See supra* note 82.

151. Braucher, *supra* note 9, at 706-07.

152. *Id.*

153. *Id.* at 708

There is mounting evidence that in the real world of contracting parties, people seek other goals besides wealth maximization in their business relationships.[154] An effort by scholars and legal decision-makers to support the cultivation of norms of cooperation by private parties could be rooted in the instrumental conception of contract, but would emphasize a prominent place for cooperation in the strategic collaboration (as opposed to wealth maximization). Posner's conception of contract portrays venture parties as mainly antagonistic individuals, seeking their own self-interest.[155] Changing that picture to acknowledge that venture parties place a high value on cooperation to the success of their collaboration portrays venture parties as being engaged in a more relational endeavor. This changes the approach to contract interpretation and supplying terms. Human behavioral characteristics, generally, and in the context of nascent venture parties, more specifically, helps the legal decision-maker refine his or her approach in support of the development of norms by private parties in such arrangements.

c. Behavioral/Psychological Characteristics Relevant To The Nascent Venturer

The behavioral characteristics which this Article suggests merit more attention from legal decision-makers when considering the propriety of alternative legal methodologies in the nascent venture context are "bounded rationality,"[156] generally, and certain of its component parts including the "availability heuristic"[157] and "overconfidence bias" (sometimes referred to as "overoptimism bias."[158] A separate, though overlapping area of concern is the impact that the social context of the nascent venture might have on the decision-making of parties to such ventures.[159] These behavioral characteristics and patterns impact individuals' decision-making in the initial formation of ventures, and in the legal instruments and contracts setting forth the relationship of the business entity to the various co-venture parties, and the relationship of the venture parties to each other.

Experimental evidence has revealed that people act with "bounded rationality."[160] This means that in the face of very complex decisions, people adopt heuristics, or short-cuts to enable them to make decisions more

154. *See* Jolls, *supra* note 32, at 1479 (referring to bounded self-interest).

155. *See* Beerman, *supra* note 4, at 560 ("The legal system suffers if it adheres to a false picture that portrays these relationships only as antagonistic individuals competing in the marketplace.").

156. *See* Jolls, *supra* note 32, at 1477-78.

157. *Id.* at 1477.

158. *Id.* at 1541-42; *see also* Korobkin & Ulen, *supra* note 50, at 1091.

159. *See* Coffee, *supra* note 67, at 1677-78.

160. *See* Jolls, *supra* note 32, at 1477-78.

quickly and at less expense.[161] An attempt to gain complete information, in order to make more perfect decisions in any given situation, would be both time consuming and likely costly.[162] Bounded rationality is relevant to the nature and content of rights and duties individuals obligate themselves to via a business firms' principle intra-firm contracts because bounded rationality results in judgment errors.[163] Do individuals who must place higher degrees of reliance on bounded rationality when forming a business venture incur more errors structuring their principle rights and obligations vis-à-vis a new venture than do more sophisticated, experienced co-venture parties? If so, how should legal decision-makers factor that into their interpretation and enforcement of such contracts? Should there be a stricter interpretation or looser interpretation of particularly harsh or inequitable terms? Since most folks learn from experience and repeated interactions in a given endeavor, this Article suggests that legal decision-makers consider whether parties in the nascent venture context act with greater reliance on bounded rationality than more experienced co-collaborators due to the level of inexperience and/or unsophistication of some nascent venture parties. This is particularly important if the strategic collaborations of nascent venture parties are found more prone to impart negative externalities. This suggests a possible justification for minimal state involvement.[164]

One component of bounded rationality and parties' use of heuristics is the "availability heuristic."[165] According to Professors Jolls, Sunstein and Thaler, "People's judgments about probabilities will often be affected by how available other instances of the harm in question are, that is, how easily such instances come to mind."[166] A question which merits more examination is whether the availability heuristic functions differently for nascent venturers than it does for more seasoned co-venturers. If it is assumed that nascent co-venture parties lack extensive experience in implementing a business plan, nor much experience in anticipating the myriad pitfalls of collaborative ventures,[167] then the availability heuristic might cause them to underestimate the necessity of specificity in describing fiduciary duties, for example. Since such parties are less likely to have experienced the impact of venture documents which are less than explicit, they may not be inclined to place the requisite level of importance on such matters. However, regarding more experienced co-venture parties, the availability heuristic might have an opposite effect. Co-venture parties who are more experienced in the

161. *Id.* at 1477.
162. *See* Korobkin & Ulen, *supra* note 50, at 1077.
163. *See* Jolls, *supra* note 32, at 1477.
164. *Id.* at 1541.
165. *Id.* at 1518.
166. *Id.*
167. *See generally infra* Part IV.B.

marketplace might tend to overestimate the potential for opportunistic conduct, and create contractual and/or fiduciary obligations that are very detailed. While such specificity might also represent a judgment error, one wonders if the push in the direction of more detailed and clear intent is more advantageous to the successful implementation of the venture than inattention to such detail pushing in the opposite direction. Interestingly, however, there is evidence that some parties, usually more experienced in business contracting, leave intentional gaps in their contracts as a method of cultivating trust and cooperation among the parties to the contract.[168] Of interest is whether the availability heuristic has any impact on such parties' choice to leave intentional gaps as an experimental alternative to a more overly detailed contract. Perhaps being more highly sensitive to past venture issues that resulted in increased tensions, the availability heuristic pushes more sophisticated venture parties to cultivate alternative strategies thought to alleviate such tensions, rather than relying on more explication in the contract. However, with respect to nascent venture parties, this Article suggests that legal decision-makers might consider the likelihood that the availability heuristic might inadequately signal to such co-venture parties that more precise planning regarding venture party rights and obligations is needed.

The "overconfidence bias" (also referred to as the "overoptimism bias,"[169] comes into play even when parties *are* able to gauge the actual probability of a particular event occurring.[170] Overconfidence bias by a venture party is the belief that good things are more likely than average to happen to such party and that bad things are less likely than average to happen.[171] Obviously, overconfidence bias can result in nascent venture parties not adequately considering the likelihood that a prospective venture could go sour, and taking steps to either lessen that possibility or drafting contract terms to address those issues should they occur.

Whereas the above behavioral factors are related to strategizing in the face of uncertainty, there is another psychological factor that is closely associated with the social context in which nascent venture parties contract. This factor concerns nascent venture parties and their desire not to sour prospects for the deal, and has been very aptly described by Professor Coffee: "the process of contracting about a long-term business relationship in which one party must place trust and confidence in another makes it difficult to explore the 'downside' possibilities that such party will be defrauded. To focus on such possibilities is to "queer" the deal. This

---

168. *See* Ayres & Gertner, *supra* note 43, at 94-95 (discussing strategic incompleteness).

169. *See supra* note 158.

170. *See* Korobkin & Ulen, *supra* note 50, at 1091.

171. *See supra* note 158.

observation goes not to cognitive limits, but to the social processes of contracting, and is probably most obvious in the kind of face-to-face individual negotiations that characterize closely-held firms."[172] Indeed, anecdotally, the author of this Article has on more than a few occasions attempted to focus clients on certain aspects of prospective collaborations that potentially pose great risk, only to be told by the client "that this is like a marriage", and that the client would rather not deal with the particular issue ex ante. This direction would seem to ignore (i) the prevalence of pre-nuptial agreements, and (ii) the high incidence of divorce in our society.

## III. THE IMPORTANCE OF FOCUS ON THE ADVANCEMENT OF DOCTRINE FOR THE NASCENT ENTREPREPRENEURIAL VENTURE

In Part II of this Article, some groundwork was laid to help better visualize the type of entrepreneurial venture and venture party with which this Article is concerned. Prior to a more detailed discussion on the precepts of Delaware law as related to the nascent venture (Part IV herein), it is helpful to re-emphasize the general matter with which this Article is concerned: setting forth a suggested framework in which to approach innovation in law, in the nascent venture context, and with a view to strategic norm development.

### A. Legal Evolution And The Nascent Venture(r)

If it is desired that law comfortably accommodate the dynamics of the entrepreneurial venture, then also it must be innovative.[173] Yet, in advocating steady, incremental changes to keep law up-to-date and relevant, law must remain tethered (at least loosely) to precedent,[174] to avoid the risk that prescriptive measures forwarded by scholars and legal decision-makers[175] will suffer a deficit in persuasive value.[176] There lies the classic

---

172. *See* Coffee, *supra* note 67, at 1677-78.

173. *See* Hobbs, *supra* note 8, at 250 (stating "legal practitioners and scholars can be a part of this process by utilizing traditional legal concepts in innovative ways and creating new methodologies that enhance entrepreneurial possibilities"); Mayer-Schonberger, *supra* note 32, at 28 (stating "there is no inherent disadvantage for using the legal system preemptively to try to facilitate the right mix for entrepreneurial success."); Gillian K. Hadfield, *Producing Law For Innovation in* RULES FOR GROWTH_ 23, 25 (R. Litan, et. al, eds., 2011) (discussing the need to explore the nature of the legal rules necessary to achieve the dynamic goals of growth and innovation).

174. *See generally* Allan C. Hutchinson, *Work-In-Progress: Evolution And The Common Law*, 11 TEX. WESLEYAN L. REV. 253 (2005).

175. *See* Beerman, *supra* note 4, at 560.

176. *See* Rubin, *supra* note 3, at 1867; *see also* Richard A. Posner, *Legal Scholarship Today*, 115 HARV. L. REV. 1314, 1322 (2002).

dilemma, and the challenge to the instrumental use of law as a facilitator of entrepreneurship.[177]

The concern is with how actually to evolve the law. One commentator defines the term "legal evolution" simply as the "development of the law over time."[178] Further, legal rules, or sets of legal rules, together with their enforcement mechanisms, can be defined as institutions.[179] Within the context of this Article's nascent entrepreneurial venture, the issue is two-fold: First, in what way(s) do we want law relative to the collaborative entrepreneurial venture to evolve? Secondly, by what mechanisms and/or methodologies can we effect this evolution? Of course, as discussed in this Article, the scholar and legal decision-makers must also be concerned with the institutional precepts of the governing law of the venture – Delaware LLC statutory law in this case.

The nascent venturer (or the scholar, practitioner, or legal decision-maker) might seek to investigate what are the most promising strategies employed by larger, more mature companies to determine in which directions to evolve. The literature suggests that certain larger, more mature companies focus on relationship building in their initial approach to contracting, at the onset of their new collaborations. This approach is designed to endogenize trust and cooperation. The companies in this space sometimes eschew classical contract's emphasis on ex ante presentation in the earliest stages of their collaborations in favor of strategies that emphasize norms of cooperation.[180] Of course, certain experienced co-venturers are more likely to be repeat players in these types of arrangements, and thus have a strong reputational interest in being viewed

---

177. Of course, this statement presumes that economic growth in the U.S. via entrepreneurship is normatively a "good" goal and one that the law should properly promote. Undoubtedly, some may argue that this needs more empirical support, but many commentators have noted that as a matter of public policy, government, historically, has viewed economic growth as a proper justification for involvement (i.e. regulation) in private affairs. *See* Callison & Vestal, *supra* note 144, at 495 (noting that since 1937 the U.S. Supreme Court became supportive of regulatory interference in the economy and stating "In the contest between unrestrained individual contractual freedom and contractual freedom constrained by public interest considerations, public interest carried the day and the United States economy has been highly regulated ever since"); Hadfield, *supra* note 173, at 25 (noting that "[t]he regulatory goals of the twenty-first century are far more complex. We do not merely want to constrain monopoly power; we also want to foster economic growth and innovation to achieve a diverse set of public and private goals"); Hobbs, *supra* note 8, at 288.

178. Elaine Mak, *Understanding Legal Evolution Through Constitutional Theory: The Concept Of Constitutional (IN)-Flexibility*, 4 ERASMUS L. REV. 193, 193 (2011-2012).

179. *See* Klaus Heine, *Introduction: Understanding Legal Evolution*, 4 ERASMUS L. REV. 127, 127 (2011-2012).

180. *See infra* Part III.B; *see also supra* note 10 (defining this Article's use of the term "norms of cooperation").

as cooperative, if they are to attract co-venturers in the future.[181] This reputational constraint on non-cooperative behavior is generally not available to start-up co-venture parties because often they are first-timers, and not necessarily poised to be repeat players.

Thus, the practices of more experienced venture parties would suggest that one avenue of evolution for the nascent venture might be to focus on the development of relational norms (such as cooperation) within their particular contractual environment, including social context. To be sure, there are other factors that can positively or negatively impact venture success, such as venture party technical expertise, financial management of the venture, etc. One initial hurdle may be to apprise the nascent venture(r) of the significance of endogenizing cooperation amongst the venture parties. In this Article's view, from the vantage point of the nascent venture party, cultivating norms of cooperation may not be high among the hierarchy of inputs in structuring the enterprise. As discussed in the Introduction to this Article, this is due in part to transactional cost constraints [182] and, frankly, lack of experience pointing to norms of cooperation as having significant value to the enterprise. Maybe the cultivation of norms of cooperation just seems too murky a concept for start-up venture parties to focus on when they are very eager to implement a new venture. Legal decision-makers can play a key role if able to more rapidly facilitate the transfer of welfare-enhancing practices to newer ventures; welfare-enhancing practices that legal decision-makers become aware of from a variety of sources, including scholars, practitioners, and from observation and interaction with parties in the more mature venture market (including contact with such parties via adjudication of disputes). This is a use of the "feedback loop" in common law,[183] in that the legal system receives information from the social context in which its rules are applied,[184] and develops new approaches more accommodative to those who use the law in structuring their activities.[185]

---

181. *See* Gilson, *supra* note 17, at 1379 ("In this case, performance is encouraged and breach penalized by the cancellation of expected future dealings with the counterparty, by the loss of reputation (with the resulting reduction in future business with other potential counterparties in the relevant economic and social communities.")).

182. *See supra* p. 7 and note 24.

183. *See* DiMatteo, *supra* note 13, at 792 n. 265.

184. *Id.*

185. *See* Hadfield, *supra* note 173, at 30 ("If we want to risk investing time, opportunity, and wealth into a joint venture with someone, our ability to do so is structured by the quality and reach of our legal infrastructure. And like physical infrastructure, what we care about is what we can do and at what cost with the tools actually available to us in the infrastructure, not the blueprint for the system as designed by its engineers.").

B. The Role Of Norms Of Cooperation

Law is often steeped in norms.[186] These norms represent beliefs about the way society or its institutions should be organized or how they should operate.[187] Notions of fairness, freedom, governmental non-intervention, or economic efficiency, all represent norms on which legal principles are based.[188] When parties collaborate to exploit an entrepreneurial opportunity via a start-up or emerging venture,[189] these co-venture parties transact with each other in a relational context.[190] In the absence of the parties intentionally structuring their collaboration to strategically emphasize chosen norms (or lacking knowledge of which norms might be venture enhancing), the norms which might spring forth to govern the co-venturers' relationship are shaped by the legal infrastructure in which the parties must operate. Relational norms such as cooperation, compromise, and participation might take a back seat to norms which amplify income-maximizing behaviors,[191] and which might not be as suitable for a collaborative venture in its earliest stages.

When co-venture parties employ relational contracting strategies, these strategies encourage a learning process amongst the collaborators;[192] an opportunity to have a sort of "test run" if you will. Among the reasons such strategies hold promise is because at the onset of the initial relationship, the parties contract with a goal of gradually raising the level of trust, rather than contracting at their existing level of trust. [193] In this sense, the parties are acknowledging that their collaborative venture could fail if they cannot be confident that their co-partners will have a willingness to be flexible and cooperative in changing circumstances. They contract with a view to placing trust and cooperation high in the hierarchy of factors important to the success of the collaboration. Their relationship is not so much based on traditional bargain theory, where the contract is viewed as an exchange, but rather norm-based, where relations are deemed more important in cultivating the venture. Some of these new contracting methods

---

186. *See* Rubin, *supra* note 2, at 1893.

187. *Id.* at 1851.

188. *Id.*

189. *See supra* note 5.

190. *See supra* note 9.

191. *See* Gilson, *supra* note 17 (discussing how certain contractual provisions might crowd out "norm-based social behavior" and renders parties more likely to make income-maximizing decisions").

192. *See* Gilson, *supra* note 24, at 476-77 (referring to a type of contract that "operates entirely as a governance structure that facilitates learning about the parties' capabilities."); DiMatteo, *supra* note 13, at 774 ("Because of the uncertainty that is inherent in collaborative innovation, a contract's main function is to institutionalize [a] learning process.").

193. *See* Gilsen, *supra* note 17, at 1382, 1385.

are not contemplated by current contract theory.[194] As mentioned in the Introduction to this Article, examples of some of the contracting strategies employed include "strategic bundling," "sequential contracting," and the "braiding" strategy described by Professors Gilson, Sabel, and Scott.[195] These relationship building contracting strategies share some common themes:

(1) Like all contracting parties, the parties in these collaborative alliances seek predictability in their business relationships. However, in the early stages of their ventures, these parties place a higher value on gauging the predictability of their partners' disposition in changing circumstances, rather than predictability achieved through attempting to write a complete contract, ex ante. At least at the start of their collaboration they seem to reject the contractarian's (and classical contract's) more narrow goal of predictability geared towards precise forecasting of future events (i.e. presentiation). Instead, at the outset, they believe a focus on successful development of the relational aspects of the venture is more predictive of the future success of the venture.[196]

(2) They recognize that certain collaborative undertakings necessarily operate in an environment of high uncertainty, so they seek to create custom governance structures to both foster a learning process and to lessen the possibility of opportunistic[197] conduct by their co-venture parties.[198]

(3) These parties acknowledge that fairness and reciprocity are often more crucial to their overall purpose and business success than rigid contracts embracing classical contract's traditional risk allocation schemes.[199]

These relational contracting strategies do not appear to have received much scholarly attention with regard to their applicability to the nascent venture. Among likely reasons for this are transaction costs in structuring more innovative business relationships, which established companies are in

---

194. *See* Gilson, Sabel, Scott, Braiding, *supra* note 17, at 1383.

195. *See supra* notes 5-17 and accompanying text.

196. *See* DiMatteo, *supra* note 13, at 771 ("A thoughtful process involving the recognition of the intersection of the intersection of business purpose and goals and legal strategy at the formation of a new enterprise is predictive of the long term longevity of viability of that enterprise.").

197. *See supra* note 76.

198. *See* Gilson, *supra* note 24, at 455 ("The transaction structure must provide mechanism for the sharing of information between the parties. In particular, the parties need credible information about each other's technical capacity, ability to manage a collaborative effort, capability for cooperative interaction, and especially each party's capacity to deal productively with disagreements that necessarily will arise when the characteristics of the desired innovation cannot be specified in advance.").

199. *Id.* at 449 ("In this environment, we observe contracts in which parties create elaborate governance mechanisms in lieu of the more familiar risk-allocation provisions of conventional contracts.").

a better position to bear than most start-ups. However, in this Article's view, this factor should be viewed as a feature of the contractual environment[200] in which the nascent venture must operate. Within this given contractual environment, legal decision-makers might fashion doctrinally base methodologies or approaches designed to compensate for this impediment to efforts to endogenize norms of cooperation. If the main purpose of relational contracting approaches is essentially an effort by private parties to reveal to each other private information helpful in making business investment decisions and the strategies to pursue, then legal methodologies designed to nudge that process along might be beneficial. Also, if there is evidence from the more mature marketplace that certain relationship building strategies are effective, but which have not trickled down to the nascent venture market, legal decision-makers should consider the possibility of the existence in the nascent venture context of certain path dependencies characterized by sunk costs and complementarities tending to emphasize current arrangements and practices not thought as beneficial.[201]

The characteristics of the collaborative start-up or emerging venture closely align with those of more established co-venture parties.[202] Co-venturers in the nascent venture context share more in common with established co-venture parties in their initial collaborations than what they might be distinguished by. If there are contracting strategies in other collaborative contexts which emphasize relational norms, and which are proving successful, then it is worthwhile to eventually explore adapting those strategies to the start-up and emerging entity context.[203]

## IV. THE LIMITED LIABILITY COMPANY, THE SIGNIFICANCE OF DELAWARE, AND THE CONTRACTARIAN APPROACH

In order that judges are comfortable either invoking policy as a basis for decision-making, or developing alternative frameworks to address emerging societal concerns, they require a framework which supports their approach, including how that approach can be reconciled with existing doctrine.[204] This effort requires a comprehensive understanding of the institutional arrangements which are the focus of judicial analysis. As related to this Article, the relevant framework should include an

---

200. *See supra* note 25.

201. *See* Bebchuk & Roe, *supra* note 26, at 155-56.

202. *See infra* Part II.B.1.b.

203. Of course, "adaptation" implies that nascent venture parties will not always be in a position to simply copy the practices of more mature venture parties, but will have to fashion strategies suitable for their contractual environment.

204. *See supra* note 3 and accompanying text.

understanding of the LLC, and the significance of Delaware and its contractarian philosophy.

A. The LLC And The DLLC Act

In a relatively short period, the LLC has emerged as one of the leading business forms for starting new entrepreneurial ventures,[205] and Delaware has long held a dominant position as the state of choice for formation of such ventures, as well as for other business forms.[206] Among the oft-repeated reasons for the popularity of the LLC form is the limited liability it offers its members and managers, the lesser burden it places on businesses to follow many of the organizational formalities required of certain other business forms (s-corporations or c-corporations, for example), flow through taxation, and great flexibility in allowing parties to contractually structure their business relationships.[207]

Parties who form a new entrepreneurial venture together in Delaware, in the LLC form, and then who proceed to create an LLC operating agreement (an LLC's governing document), form a contract together.[208] This contract represents both a managerial and legal tool in implementation of a new venture,[209] and is a singularly labyrinthine instrument.[210] Its jumble of

---

205. *See* John M. Cunningham & Vernon R. Proctor, *Drafting Limited Liability Company Operating Agreements*, §1.01, 1-3 (2013-1 Supplement) (stating that "presently there are at least 10 million LLCs in good standing in the United States, and thousands of new ones are being formed every day."); Steele, *supra* note 105, at 9 n.30 (noting that as of March 2005 there were more domestic limited liability companies registered in Delaware (288,809) than domestic corporations (274,905); Callison & Vestal, *supra* note 35, at 272, n.4 (2001) (noting that by 1996 all fifty states and the District of Columbia had enacted LLC legislation); Joshua P. Fershee, *LLCs And Corporations: A Fork In The Road In Delaware*? 1 HARV. BUS. REV. ONLINE 82 (2011) (noting "the limited liability company (LLC) has evolved from a little used entity option to become the leading business entity of choice").

206. *See* Miller, *supra* note 74, at 566.

207. *See* Cunningham & Proctor, *supra* note 207, at 1-7; Miller, *supra* note 74, at 612; Callison & Vestal, *supra* note 35, at 275.

208. The Delaware Limited Liability Company Act (the "DLLC Act") is clear that the LLC operating agreement is a contract. *See* DEL. CODE ANN. tit. 6, §18-1101(b) (West 2013) ("It is the policy of this chapter to give the maximum effect to the principle of freedom of contract and to the enforceability of limited liability company agreements."); DiMatteo, *supra* note 13, at 732 (stating "the LLC is almost completely contractual in nature, with the operating agreement acting both as a foundational document and as a governance structure"); DEL. CODE ANN. tit. 6, §18-101(7) (West 2010) (defining "limited liability company agreement", and indicating that it may be called an operating agreement, and that such agreement "governs the affairs of the limited liability company and the conduct of its business").

209. *See* Salbu, *supra* note 11, at 398 ("In any collaborative effort, contracting choices are managerial as well as legal, affecting the strategic implementation of the venture."); DiMatteo, *supra* note 13, at 771 (stating "the notion of law as business method is understood within a 'legal-managerial' framework."). The typical LLC operating agreement

provisions, and myriad implications for the new start-up venture, commands that clients and their counsel give it careful scrutiny. No less august an institution than the Delaware Supreme Court agreed that the statute which Delaware LLC operating agreements are based on – the DLLC Act – is rife with complexities.[211]

Under the LLC statutes of most states, the parties to such contracts have a wide breadth of freedom to arrange and structure their business relationship, and to have their private ordering respected and enforced by the courts.[212] This is often referred to as the policy of 'freedom of contract', and it has its origins in the business organization theory known as contractarianism.[213] The DLLC Act is considered the most contractarian among such statutes in U.S. jurisdictions because it has very few mandatory provisions with which parties to LLC operating agreements must comply. As Callison and Vestal have stated, "LLC law in the United States has become the contractarian test case,"[214] a "contractarian dream entity."[215]

### B. The Delaware Courts' Approach To Nexus-of-Contracts Theory: A Divergence Of Thought

Any critical inquiry into developing methodologies or approaches that might be effective in evolving the LLC nascent entrepreneurial venture toward more relational norms within Delaware's contractarian framework must include an understanding of the nexus-of-contracts theory that underlies contractarianism. The contractarian philosophy views the company as a nexus-of-contracts, and not as an entity subject to regulation by the state by virtue of the fact that the state granted the entity formation charter.[216] Rather, in the contractarian view, the new entity is not a distinct

---

contains the equity members' rights and obligations vis-à-vis each other and the company, and also contains detailed provisions related to how the company shall operate. In contrast, a c-corporation usually will have separate documents covering shareholders, and the company by-laws.

210. The *Elf Atochem v. Jaffari* case was one of the first Delaware Supreme Court cases where the court articulated the policy of "freedom of contract." Regarding the DLLC Act, the statute on which Delaware LLC operating agreements are based, the court stated, "To understand the overall structure and thrust of the Act, one must wade through provisions that are prolix, sometimes oddly organized, and do not always flow evenly." Elf Atochem N. Am., Inc. v. Jaffari, 727 A.2d 286, 291 (1989).

211. *Id.*

212. *See supra* note 210.

213. *See* Callison & Vestal, *supra* note 144, at 497; Miller, *supra* note 74, at 569-70; Coffee, *supra* note 67, at 1618-19; GRT, Inc. v. Marathon GTF Tech., Ltd, 2011 WL 2682898, *12 (Del. Ch.) (noting that Delaware is "more contractarian" than many other states and that "parties' contractual choices are respected").

214. *See* Callison & Vestal, *supra* note 144, at 496.

215. *Id.*

216. *See* DiMatteo, *supra* note 13, at 784; Miller, *supra* note 74, at 580.

unit with its own legal identity, but is merely a nexus-of-contracts amongst the creators of the entity and various persons involved with the company.[217] As the new company only represents contracts, the state is deemed to have a truncated role – limited to enforcing the contracts, and imposing as few rules or regulations as possible so as not to interfere into the private ordering of the parties.[218] Further, in the contractarian view, were it not for the presence of transaction costs there would be no default rules or terms at all (i.e. rules and/or terms that the parties are free to eliminate in their LLC operating agreements). The freedom of contract underlying the contractarian approach as applicable to LLC's allows the parties to determine their rights and obligations, even if their agreement permits self-interested actions that most scholars and legal decision-makers would agree threatens the viability of the collaborative relationship.[219] This is in contrast to c-corporation statutes, for example, that limit corporate directors' rights to engage in interested transactions.[220]

What is not readily apparent from the Delaware judicial opinions involving freedom of contract issues in the LLC context is the recognition that there are multiple nexus-of-contracts approaches.[221] According to one commentator, "The two main schools of nexus-of-contracts theory are the agency theory of contracts and the social contract theory. The former view is premised on a limited view of human nature. Under agency theory, human interaction and contracting is solely characterized as adversarial and opportunistic in nature. Social contract theory takes a broader communitarian view of human relationships."[222] Where ventures are characterized as more relational (such as in the nascent venture context) legal decision-makers in Delaware might pursue greater understanding and acceptance of the social contract theory as a basis for judicial intervention, when appropriate. This approach avoids abandoning the tenets of contractarian theory, but adopts it to the evolving aims of the law. This Article presents only a cursory discussion on social contractarianism. The author intends to revisit this subject in the near term and present a more fulsome analysis.

C. The Philosophical Debate: *Cantor*, *Auriga* and Recent Developments

In what can be characterized as an ongoing philosophical debate about what the judiciary's commitment ought to be to contractarianism and its

---

217. *See* McConvill & Bagaric, *supra* note 66.
218. *See* DiMatteo, supra note 13, at 784-85; Miller, *supra* note 74, at 569-70, 580.
219. *See* RIBSTEIN & KEATINGE, *supra* note 90, at 31.
220. *Id.*
221. *See* DiMatteo, *supra* note 13, at 768 n.242.
222. *Id.*

nexus-of-contracts theory in the LLC context, the Delaware Court of Chancery (hereinafter "the Court of Chancery") and the Delaware Supreme Court have played a central role.[223] This debate has been characterized by judicial disagreement regarding the existence of default fiduciary duties of managers/members in the LLC and limited partnership context. Since several articles and cases have eloquently set forth the arguments for both sides of this debate, this Article engages only in a cursory review.[224] In general, the Court of Chancery most recently has been of the view that default fiduciary duties exist in the LLC context, allowing common law doctrine to apply in the LLC context.[225] On the other side of this debate, the Delaware Supreme Court, along with the current Chief Justice of that court, Myron T. Steele, has been more hostile to that view, generally taking the position that the parties' express contract should be the principal point of inquiry.[226] It is worth noting that the Delaware Supreme Court is the final arbiter of Delaware law, and has yet to squarely decide the issue of default duties in the LLC context.[227]

With the Delaware Court of Chancery's decision in *Cantor*,[228] legal decision-makers are presented with a strong freedom of contract decision that also gives license to consider the context of business arrangements as a significant factor, adopting a more relational approach. *Cantor* is an interesting case because it was written by the Chief Justice Myron T. Steele prior to his appointment to the Delaware Supreme Court, but while he served as a Vice Chancellor on the Delaware Court of Chancery. As Chief Justice Steele is thought a leading proponent of the contractarian philosophy,[229] one might consider that Cantor represents thinking that is consistent with that philosophy. However, it is not clear to what extent

---

223. On its website, the Delaware Court of Chancery states that it is widely recognized as "the nation's preeminent forum for the determination of disputes involving the internal affairs of the thousands upon thousands of Delaware corporations and other business entities through which a vast amount of the world's commercial affairs is conducted. Its unique competence in and exposure to issues of business law are unmatched." *See Welcome to the Delaware Court of Chancery*, DELAWARE STATE COURTS, http://courts/state.de.us/chancery. However, the Delaware Supreme Court is ultimately the final arbiter on matters of Delaware law. *Feeley*, 62 A.3d at 663.

224. *See* Steele, *supra* note 105; Steele, *supra* note 106; J. WILLIAM CALLISON & ALLAN W. VESTAL, TRIPLE ERROR: CHIEF JUSTICE STEELE AND DEFAULT CONTRACTUAL DUTIES IN DELAWARE LIMITED LIABILITY COMPANIES AND LIMITED LIABILITY PARTNERSHIPS 7 (2011); Miller, *supra* note 74; Auriga Capital Corp. v. Gatz Properties, 40 A.3d 839, 849 (2012); *Feeley*, 62 A.3d at 659-63; *Cantor*, 2000 WL 307370 at *10.

225. *See Auriga*, 40 A.3d at 849; *Feeley*, 62 A.3d at 659-63.

226. *See* Gatz Props., L.L.C. v. Auriga Capital Corp., 59 A.3d 1206, 1218-20 (Del. 2012); Steele, *supra* note 105, at 9; Steele, *supra* note 106, at 237.

227. *See Feeley*, 62 A.3d at 663.

228. *See Cantor*, 2000 WL 307370 at *10.

229. *See* Steele, *supra* note 105; Steele, *supra* note 106.

Chief Justice Steele and the Delaware Supreme Court would extend the ruling to situations represented by this Article's nascent venture hypothetical. Although *Cantor* involved a Delaware limited partnership and not an LLC, the DLLC Act mirrors the Delaware limited partnership statute.[230]

Prior to *Cantor*, the prevailing thinking had been that business partners that "neither managed, operated, nor governed the partnership" could not owe fiduciary duties to a partnership or other business entity.[231] Limited partners are generally passive investors, so unless they participate in management, ordinarily they would not be deemed to stand in a fiduciary capacity.[232] But in *Cantor*, the court held that limited partners could contractually be bound to a fiduciary duty of loyalty.[233] This was significant because it clarified that even if the common law would not have deemed "passive investors" as acting in a fiduciary capacity, that other factors could override that assumption.

But, in determining that limited partners could be contractually bound to a fiduciary duty, Vice Chancellor Steele's analysis comes across as a bit strained,[234] lending some credence to indeterminacy theory.[235] Perhaps surrendering to an insecurity that his argument for imposing fiduciary duties on limited partners based on the *Cantor* facts was not wholly persuasive, he injected context into the analysis to buffer his argument.[236] In referring to the limited partner defendants in the case, the court stated, "The success of this still highly personalized business activity depends in large part on the stability of the Partnership and a sense of commitment to a common purpose."[237] Further, the court stated that the "Limited Partners, like partners in a general partnership, must be able to rely on a mutuality of commitment

---

230. *Elf Atochem,* 727 A.2d at 290 ("The Delaware LLC Act has been modeled on the popular Delaware LP Act. … The policy of Freedom Of Contract underlies both the LLC Act and the LP Act.").

231. *See Cantor*, 2006 WL 307370 at *18.

232. *See Feeley*, 62 A.3d at 662; RIBSTEIN & KEATINGE, supra note 90, at 507.

233. *See Cantor*, 2006 WL 307370 at *23.

234. *Id.* at *22 (referring to a definition in Black's law dictionary to provide a more expansive definition of "fiduciary duty"). *See also id.* ("[U]nprecedented or not, the Limited Partner Defendants cannot credibly argue that they have not knowingly and willingly accepted the obligation of a fiduciary duty of loyalty to the CFLP Partnership. And, in this situation, holding that the parties….could bargain to impose a fiduciary duty of loyalty on the limited partners is not remotely offensive to any concerns of public policy.").

235. Some Critical Legal Studies adherents assert that formal contract rules are indeterminate because they do not dictate any particular result in a case, or at least in any important case. *See* Hillman, *supra* note 10, at 106-07; Clare Dalton, *An Essay In The Deconstruction Of Contract Doctrine*, 94 YALE L.J. 997, 1007 (suggesting that "legal doctrine is unable to provide determinate answers to particular disputes while continuing to claim an authority based on its capacity to do so").

236. *See Cantor*, 2006 WL 307370 at *22.

237. *Id.*

and purpose."[238] Lastly, in fashioning a remedy, the court noted that the parties' legal wrangling to date had been "a diversion of economic resources", had not moved toward a "healing process" and that the court's remedy should "destroy no party in the process."[239] This approach veers towards the relational sphere in that it seeks to continue the beneficial relationships which further the business purpose, rather than ultimate, final resolution for one party or the other.[240] One does wonder if Chief Justice Steel framed the breach in question in terms of fiduciary duties (as opposed to contractual breach) in order to justify the imposition of equitable remedies. It could be argued that the *Cantor* case provides a foundation for legal decision-makers in Delaware to consider the context in which parties to the nascent entrepreneurial venture transact with each other. Consideration of context is an acknowledgement that such parties transact in a relational capacity, rather than strictly on an exchange basis. The fairly recent *Auriga* case is consistent with *Cantor*, in that the Delaware Court of Chancery looked to the status of the parties in context of their business relationship, as opposed to their contractual relationship.[241] In *Auriga*, the court decided that certain default common law duties would be applicable (and were applicable) to business parties based on the context of their relationship (i.e. their status within the collaboration), unless such duties are expressly restricted or eliminated in the LLC operating agreement.[242] Thus, whereas *Cantor* made clear that parties have the freedom of contract to privately order their relationships in derogation of the common law (i.e. imposition of fiduciary obligations to persons to whom such obligations would not traditionally apply), the Court of Chancery in Auriga was of the view that parties could default into the common law if (i) the common law would traditionally view any such parties as having the status of a fiduciary, and (ii) such parties failed to use their freedom of contract to eliminate or restrict any default rules emanating from the common law. But, subsequent to the Court of Chancery's decision in Auriga, the Delaware Supreme Court, in an en banc decision which included current Chief Justice Steele, affirmed the Court of Chancery's decision based on an interpretation of the parties' contractual provisions,[243] rather than any consideration of default fiduciary duties. Further, the Court expressly dismissed the Court of Chancery's discussion of default fiduciary duties.[244] Even though affirming

238. *Id.*
239. *Id.* at *29.
240. *See* Salbu, *supra* note 11, at 405; *see* Linzer, *supra* note 9, at 173-74.
241. *See Auriga*, 40 A.3d at 850 (discussing that traditional principles of "equity" apply in determining if a manager of an LLC is a fiduciary).
242. *Id.*
243. *See Gatz*, 49 A.3d at 1213.
244. *Id.* at 1218-20.

the Court of Chancery's decision in *Auriga*, the Delaware Supreme Court sought to pull the matter squarely back into contract, adhering to a contractarian approach.

A fairly recent development in Delaware bodes well for parties engaged in nascent entrepreneurial ventures, and for the ideas espoused in this Article. On March 20, 2013, legislation proposing to amend the DLLCA was submitted to the Corporation Law Section of the Delaware State Bar Association. If the proposed legislation is enacted, the amendments, in addition to certain technical changes, would confirm that LLC managers owe fiduciary duties where the LLC agreement is silent. If approved, this legislation would settle the debate between the Delaware Court of Chancery and the Delaware Supreme Court on this issue, with the Court of Chancery's approach controlling. Of course, in Delaware the default level of any such fiduciary duties is a matter that is determined within the context of the specific venture or transaction.[245] This matter is taken up in the next section (Part V) of this Article.

## V. THE NATURE AND CONTENT OF LAW DESIGNED TO SUPPORT THE CULTIVATION OF NORMS OF COOPERATION

### A. Prologue

Once the scholar or legal decision-maker has arrived at a more comprehensive understanding of the institutional arrangement which is the focus of the analysis, then a more credible effort to develop approaches or methodologies which might support strategic norm development can begin. To briefly review some of the points covered thus far in this Article, certain of the characteristics of the nascent venture have been set forth,[246] including theories regarding probable behavioral characteristics of nascent venture parties which can impede effective decision-making.[247] This latter point was associated with the quality, or efficacy of consent, and the choices the legal decision-maker must adopt between alternative conceptions of contract in light of the aim of developing approaches which might influence the private

---

245. Douzinas v. Am. Bureau of Shipping, Inc., 888 A. 2d 1146, 1149-50 (Del. Ch. 2006) ("Delaware's Limited Liability Company and Limited Partnership Acts permit the contracting parties to expand or restrict fiduciary duties. As a result, in the alternative entity context, it is frequently impossible to decide fiduciary claims without close examination of the governing instrument of the entity giving rise to what would be, under default law, a fiduciary relationship."); *see also Feeley*, 62 A.3d at 662 (acknowledging "situationally specific possibilities" and recognizing "that epistemological questions about the extent to which a partner or other person owes duties will be answered by the role being played, the relationship to the entity, and the facts of the case").

246. *See generally supra* Part II.

247. *See supra* Part II.B.2.

parties' bargain. The law which governs the private parties' bargain (including the attributes of the business entity and the ethos underlying its permissible organizational configurations) must also be considered. This Article's hypothetical provided a sketch of a nascent venture, formed as an LLC, in the State of Delaware.[248]

An important aspect of the contractual environment[249] of the type of nascent venture discussed in this Article is that it is governed by Delaware law[250] and that State's fulsome embrace of the contractarian philosophy.[251] Again, contractarians espouse the view that parties should be free to strike their own bargains free of external interference.[252] As such, contractarians believe that statutory business laws should be kept to a minimum, giving maximum freedom to business participants to contractually determine their legal rights and responsibilities.[253] Governmental or judicial efforts to develop methodologies to influence the cultivation of strategic norms by private parties (as proposed in this Article) impacts the contractarian philosophy in at least two ways: First, this Article posits that the more specific disclosure of fiduciary duties by private parties to the nascent venture is an initial and preliminary approach to opening up opportunities for such parties to endogenize norms of cooperation. Where there is a requirement of venture parties to more clearly and unequivocally explicate certain rights and obligations, the by-product is that courts increase the procedural costs to parties of contracting around any default rights and obligations.[254] Under Delaware's limited liability company statute (i.e. the DLLC Act), there are default fiduciary duties that apply unless those duties are eliminated, restricted or amended.[255] Increasing procedural costs by imposing an expanded and more specific writing requirement regarding fiduciary duties is a governmental intervention into the private parties bargaining process which might be deemed inconsistent with the norm of non-intervention that partially defines contractarianism.[256]

The second way that contractarian philosophy is impacted by governmental or judicial efforts to develop methodologies influencing strategic norm development stems from the fact that all contracts are incomplete, and require judges to interpret them and fill in gaps.[257] In the process of interpretation and filling in gaps, judges have to make social

248. *See generally supra* Part II.
249. *See supra* note 25.
250. *See supra* Parts II.B, IV.
251. *See generally supra* Parts II, IV.
252. *See* Coffee, *supra* note 67, at 1690.
253. *See* Miller, *supra* note 74, at 569.
254. *See* Ayres & Gertner, *supra* note 43, at 123-24.
255. *See* DEL. CODE ANN. tit. 6, § 18-1101(c).
256. *See* Miller, *supra* note 74, at 569.
257. *See supra* note 82.

policy choices.[258] There must be some guiding principle to assist judges in fulfilling this role. Arguably, the very act of interpretation or filing in gaps intrudes on the private parties bargain since it substitutes the judges view for whatever was the real (and unknown) intent of the parties at the time they struck their bargain, ex ante. However, if in the context of the nascent venture, judges decide to move away from the standard neoclassical economic view of contracts as exchanges rather than relations,[259] then perhaps in their roles interpreting and filling in gaps judges will privilege certain facts[260] which support the nascent venture as more of a relation than an exchange. The decision to privilege the narrative which supports the nascent venture as a cooperative and collaborative enterprise brushes against the contractarian tilt towards interpretation and gap filling tending to emphasize wealth maximization and parties' more self-interested behaviors.[261] As some commentators might deem (incorrectly in this Article's view) this approach more activist than the standard neoclassical approach with its attendant assumptions, this approach could appear to pose a significant challenge to the contractarian norm of non-intervention. Nevertheless, to the extent that an approach expressly acknowledging relational contract concepts represents a distinct policy choice, it is an approach which finds support in the Restatement (Second) of Contracts,[262] and in the overall philosophy of the Uniform Commercial Code (UCC).[263]

When the scholar or legal decision-maker has cogent theoretical arguments and/or experimental evidence from the behavioral sciences in her legal toolbox, and is able to knock chinks in the armor of contractarian philosophy, then there exists a firmer foundation on which to pursue approaches designed to influence private ordering, even if at first blush such approaches seem inconsistent with contractarian philosophy. Contractarian theory assumes parties could write a perfect contract were it not for the

---

258. *See* Braucher, *supra* note 9, at 733 ("To supply terms, a legal decisionmaker must make policy choices, not merely follow the directives of the parties. The law should make policy choices explicitly and not mask choices as 'consent.'").

259. *See supra* note 138.

260. *See supra* note 77.

261. *See* Coffee, *supra* note 67, at 1623 n.18 (stating how "hypothetical bargaining" focuses on wealth maximization; also that contractarians favor the "hypothetical bargaining approach").

262. RESTATEMENT (SECOND) OF CONTRACTS, § 204 cmt. d (1981) (rejecting rationale for supplied terms that "the search is for the term the parties would have agreed to if the question had been brought to their attention," and favoring rationale that court should supply term that comports with community standards of fairness and policy rather than analyze a hypothetical model of the bargaining process"). *See* Braucher, *supra* note 9 (citing to identical comment in Restatement (SECOND) Of Contracts (1979)).

263. *See* Linzer, *supra* note 9, at 166 ("Many decisions that carry out the neoclassical doctrines of the U.C.C. and the legal realists have had the effect of moving law-in-operation in relational directions.").

presence of transaction costs.[264] But, this principle of contractarianism is called into question by experimental evidence, which suggests that judgment errors contribute heavily to parties' inability to draft the perfect contract. Additionally, as previously mentioned, the social context of the nascent venture may deter parties from a more aggressive pursuit of the downside possibilities of potential collaboration. These factors are not incorporated into the contractarian philosophy. Where the nascent venture party is more susceptible to these errors in judgment than more experienced and sophisticated co-venturers, then legal decision-makers might consider application of methodologies not fitting so neatly within contractarian theory. If there are distortions in the efficacy of consent, then governmental intervention is not as easily reconciled with the emphasis on individual freedom espoused by the contractarian.[265] Explaining the link of consent to contractarianism, one commentator stated, "The link with contractarianism lies in the view that since governments characteristically encroach on the persons of those subject to them (for instance, through the use of coercion and punishment), government can be reconciled with freedom only if these encroachments can be represented as plausible subjects of consent."[266]

With respect to interpretation and filling gaps in contracts, in this Article's view there is a body of convincing evidence from the behavioral sciences, widely accepted by the scholarly community, which supports the policy approach of privileging facts tending to support a narrative of cooperation and collaboration. First, as an initial matter, judges employ the "hypothetical bargaining" construct where the express terms of the contract are insufficient to gauge parties' intent. As stated by Professor Coffee, "Contractarians favor the hypothetical bargaining approach because it presents the court in its least intrusive or regulatory guise as a body that is simply seeking to determine what the parties would have done had they focused on the problem."[267] Professor Coffee goes on to state, "Proponents of hypothetical bargaining assume that rational parties would agree, ex ante, on whatever provisions maximized value, even if the resulting gains were to be unequally distributed."[268]

Where the exercise is to determine what the parties would have done had they anticipated, ex ante, the current disagreement, ex post, legal decision-makers might ask as to whom among the parties that inquiry

---

264. *See* Callison & Vestal, *supra* note 57 at 497 ("A purely contractarian approach would include that everything can be left to the contract and that it is only the presence of transaction costs that creates default rules.").

265. *See* Scheppele & Waldron, *supra* note 57, at 199.

266. *Id.*

267. *See* Coffee, *supra* note 67, at 1623 n.18.

268. *Id.* at 1623.

should be directed.[269] There is strong evidence from the behavioral sciences that suggests that "human beings possess certain inherent capacities for social or collective action, including a bias towards altruism at least in certain contexts."[270] Moreover, these "other regarding"[271] behaviors are thought present in roughly half the population.[272] Assuming that the population of nascent venture parties also is fairly representative of this pattern, then it seems the "hypothetical bargaining" approach is just as legitimate in deferring to such members who hypothetically possess "other regarding" behaviors as it does in deferring to members who are more self-interested, thus hypothetically having a preference for wealth maximization. Choosing between these two alternatives is not neutral.[273] Again, a policy choice must be made. As previously stated in this Article, since there are multiple schools of thought on the nexus-of-contracts theory which underlies the contractarian philosophy,[274] legal decision-makers in Delaware, for example, might undertake an effort to more strongly articulate a school of thought that is more supportive of particular judicial goals. Regarding this latter point, it was suggested that a distinction between the agency theory of contractarianism and social contractarianism is merited. A version of contractarianism that incorporates more communitarian values can move the legal decision-maker closer to a hypothetical bargaining construct which focuses on those parties prone to more altruistic behaviors, rather than default to those who are more self-interested.

## B. Our Hypothetical And Greater Disclosure Of Fiduciary Duties Under the DLLC Act

### 1. *Fiduciary Duties As An Ex Ante Constraint On Opportunistic Conduct; Determining Who Is A Fiduciary*

Let us now assume that the parties in this Article's hypothetical entrepreneurial venture have successfully negotiated and executed a simple LLC operating agreement. Further we will assume that they have adopted no special language with respect to fiduciary duties. In other words, the

---

269. *See* Scheppele & Waldron, *supra* note 57, at 197.

270. Deakin, *supra* note 36.

271. *See* Lynn A. Stout, *Other Regarding Preferences and Social Norms*, *available at* http://papers.ssrn.com/paper.taf?abstract_id=265902.

272. *See* Scott, *supra* note 42, at 1644.

273. *See* Beerman, *supra* note 4, at 557 ("Furthering the operation of institutions is not neutral: the law will advance certain institutional arrangements at expense of others.").

274. *See* DiMatteo, *supra* note 13, at 768 n. 242.

venture parties in our hypothetical have neither expanded, restricted, or eliminated any of the traditional fiduciary duties which might apply by default, nor have they included exculpatory provisions from which any further intent regarding fiduciary duties might be gleaned (we will alter these facts later in this section). An obvious starting point is the question of who amongst our nascent co-venture parties has the status of a fiduciary. Any fiduciary duties would apply only to venture parties who are determined to be fiduciaries.

But, before addressing the DLLC Act and Delaware jurisprudence on the determination of who is or is not a fiduciary, let us discuss whether fiduciary duties, generally, are effective, ex ante, in policing opportunistic conduct, and encouraging more cooperative behaviors, as has been suggested by some commentators.[275] For this task, we will assume that Delaware's default fiduciary duties apply to each of the Members in our hypothetical (whether or not holding a position as Manager). Further, we can assume that our venture parties have at least a cursory understanding that certain fiduciary duties apply by default, even if (as shall be discussed later) they may not possess a clear indication of what those duties are since they are not spelled out by the DLLC Act.

In this Article's view, fiduciary duties, particularly in their construction under the DLLC Act are not very effective in policing, ex ante, non-cooperative actions by nascent venture parties because they lack salience.[276] Whatever the term fiduciary duties means and implies to an experienced transactional attorney, or a sophisticated, repeat actor in collaborative transactions, it is doubtful that the import of that meaning is understood by nascent venture parties.[277] Scholars in the behavioral sciences have noted that effective prescriptive strategies in the law should take account of the fact that vivid and personal information is often more effective than more abstract information.[278] Beyond the likelihood that the concept of fiduciary duties may be a bit cloudy to most nascent venturers, the DLLC Act does not even set forth what those duties are[279] Rather, the DLLC Act invites the Delaware courts "to make an important policy decision and determine the default level of these duties."[280] However, Delaware cases interpreting the relevant provisions of the statute have concluded that "in the absence of a contrary provision in the LLC

---

275. *See* Miller, *supra* note 74, at 583.

276. *See* Jolls, *supra* note 32, at 1537.

277. *See* Jeffrey M. Lipshaw, *The Bewitchment of Intelligence And Ex Post Illusions of Intention*, 78 TEMP. L. REV. 99 (2005) (discussing legal language and how the search for "mutually intended meaning" is a waste of time).

278. *See supra* note 278.

279. *See* Kelly v. Blum, No. 4516-VCP, 2010 WL 629850, *10 (Del. Ch. Feb. 24, 2010).

280. *Id.*

Agreement," the traditional fiduciary duties of loyalty and care are the focus of the fiduciary duty analysis.[281] Yet, even knowing what the fiduciary duties are tells nascent venturers very little about what they mean since a judge must determine that in the context of "complex relationships involving unprecedented facts."[282]

Contrast Delaware's approach to fiduciary duties with that of the ULLCA II (The Revised Uniform Limited Liability Company Act), which at least lists an abbreviated set of actions covering fiduciary duties. The ULLCA II permits "if not manifestly unreasonable," the operating agreement to eliminate the following duties: the duty to account, the duty to refrain from dealing with the LLC on behalf of a party with an adverse interest, and the duty to refrain from competing with the LLC.[283] Since the ULLCA II provides a modest indication of the behaviors to be monitored, and qualifies the permissive elimination of certain duties by adding the caveat "if not manifestly unreasonable," venture parties can glean direction on how to address other duties or rights in the context of their particular venture. If venture parties are prompted to further elucidate their rights and obligations, this serves both a cautionary and evidentiary purpose, two points later discussed herein. In an earlier draft of this Article, I was committed to an alternative labeling for the concept of fiduciary duties in order to call more attention to the behaviors and actions that the duties typically address. Businesses fail for a myriad of reasons, but chief among them are the people issues;[284] the collaborative relationships of the venture partners. Through extensive experience with the adjudication of business conflicts, legal decision-makers have learned that a number of behavioral/business relationship factors can imperil start-up ventures. I reasoned that a preferable name for these factors, a more vivid indicator if you will, is "collaboration risk factors." These factors would cover the range of opportunistic conduct, including furtive actions, attempts to compete with the venture, self-dealing, etc. Ultimately, I felt it doubtful that the label "collaboration risk factors" would catch on and abandoned that approach.

Now, returning to the matter of who is or is not a fiduciary in the context of this Article's nascent venture hypothetical. In this Article's view, this is an area that could benefit from some clarification under Delaware law as applicable to the nascent venture context. Under Delaware law, "a fiduciary relationship is a situation where one person reposes special trust in and reliance on the judgment of another or where a special duty exists on

---

281. *Id.*

282. *See* Lerner v. Westreich, 819 N.Y.S.2d 210 (N.Y. Gen. Term 2006) (applying Del. Law) (Delaware law treats allegations of breach of fiduciary duty on a case specific basis).

283. *See* Miller, *supra* note 74, at 571; Callison & Vestal, *supra* note 57, at 505-06.

284. *See supra* note 73.

the part of one person to protect the interests of another."[285] The "special duty" language in the above designation is deemed to apply to situations involving corporate directors, general partners, trustees or analogous examples of those situations.[286]

In identifying who among our nascent venture parties (from the hypothetical) would be considered a fiduciary, of concern is the part of Delaware's elucidation of the types of parties owing fiduciary duties which relates to situations where "one person reposes special trust in and reliance on the judgment of another."[287] In setting forth situations where this alternative determination would apply, the *Auriga* court suggested that it would be applicable to those members or managers "owing circumstantially-relevant duties under traditional equitable principles,"[288] and cited to *Cantor*, previously discussed in this Article.

Recall, *Cantor* involved a limited partnership, and a Delaware limited partnership statute which mirrors the DLLC Act. In *Cantor*, the limited partners of the business, who had no management authority, were found to owe fiduciary duties based on the nature of the business enterprise.[289] In strikingly relational language, the *Cantor* court stated,

> The CFLP limited partners, like partners in a general partnership, must be able to rely on a mutuality of commitment and purpose. CFLP's limited partners would not rationally warrant the ability to compete in a way that would harm the Partnership and their fellow partners – the Partnership's source of capital.[290]

In this Article's hypothetical, each of the nascent venture parties is vested with some degree of management authority in that they all participate to some extent in important decisions regarding the business. This is in contrast to the limited partners in *Cantor*, who lacked even minimal rights to participate in the management of the business. Moreover, recall from the hypothetical that although the nascent venture parties designated two (2) Members to serve as Managers for the business, they also determined that Managers would not have wide discretionary authority. In fact, one (1) of the Manager positions would rotate among the Individual Members, and Managers would only be afforded a modest higher delegation of authority for more routine day-to-day matters. The intertwined structure of the nascent venture (i.e. all the Members are equity owners of the venture and all participate in management) makes for a much stronger case than the *Cantor* facts to regard each of the nascent venture parties as fiduciaries. Each of the nascent venture parties is placing some degree of reliance on

---

285. *See Auriga*, 40 A.3d at 850.
286. *Id.*
287. *Id.*
288. *Id.*
289. *See Cantor*, 2006 WL 307370 at *22.
290. *Id.*

each of his or her co-venturers to provide an individual benefit to the collective undertaking and to each other individually. In exchange for a benefit received, each nascent venture party rationally expects to incur some type of obligation. Since they are not passive investors, there is a strong argument that in exchange for the right to participate in management they expect they each will operate in the best interest of the venture – this necessarily conveys some limits on their permitted actions. However, *Cantor* is dissimilar. The limited partners in *Cantor* gave of their money in exchange for a benefit to be received from the general partner, who is charged with an obligation of making management decisions. But, since the limited partners were not granted the privilege of management powers, it is more difficult to argue that they should expect to be bound by fiduciary obligations. The evidence of collective intent to cooperate by the parties to the nascent venture is not as clearly evident in *Cantor*.

Under the DLLC Act, there are two basic types of members: members who are also managers and exercise managerial functions in a member managed LLC, and members who are passive investors like limited partners.[291] Managers and managing members owe default fiduciary duties, passive members do not.[292] In the nascent venture hypothetical, when any of the nascent venture parties is not serving in a role titled "Manager," would such a party not be deemed a fiduciary under Delaware law? Also, since the nascent parties are engaged in a collective undertaking, in a closely held enterprise where each party is dependent on his or her co-venturers, should this be "situationally specific"[293] enough to imply that all the parties are fiduciaries?

On the basic point of attributing fiduciary duties, this Article suggest that both the merits of the argument for application of fiduciary duties, and the content of those duties are stronger based on the facts present in the nascent venture hypothetical than on the facts of *Cantor*. Callison and Vestal stated,

> When there is greater member participation, such as when ownership and management converge, the law should assume greater information disclosure rights and increased fiduciary duties. On the other hand, when there is little or no convergence between ownership and management authority, such as when members merely contribute capital and share only in the firm's reward attributes, the law should assume reduced information disclosure rights and reduced fiduciary duties.[294]

Further, in the nascent venture context, legal decision-makers should consider the degree to which a determination that each party is a fiduciary

---

291. *See Feeley*, 62 A.3d at 662.
292. *Id.*
293. *Id.*
294. *See* Callison & Vestal, *supra* note 35, at 306.

reinforces doctrinal bonds which might compensate for likely judgment errors or other decision-making deficiencies that the parties incurred in forming the venture, based on factors discussed previously in this Article. Default fiduciary principles are equitable gap-fillers,[295] and serve to fill in "the potentially considerable gaps" that might characterize the parties' agreement.[296] Chief Justice Steele, one of the leading proponents of the contractarian philosophy, has staked his support for the contractarian approach (i.e. non-intervention) largely on the parties being "sophisticated" and able to effectively negotiate their package of rights.[297] That was true for the *Cantor* parties, yet the court intervened in an unprecedented manner. Where, as in the case of our nascent venture parties, the sophistication argument is weaker, attribution of fiduciary duties to such parties may prove welfare enhancing if it encourages them to more explicitly waive those duties and/or specify more clearly their desires in the venture. This could help spur the parties to confront directly their co-venture parties' intentions, and contribute to the mutual disclosure of additional information about each others disposition towards cooperative collaboration.

There are a string of Delaware cases that stand for the proposition that non-managing members and non-controlling/minority members are not subject to the imposition of fiduciary duties.[298] It is unclear how those cases are reconciled with the imposition of fiduciary duties based on the circumstances present in a collaborative business venture, such as in *Cantor*, or upon the facts present in this Article's hypothetical nascent venture. One might read *Cantor* as an outlier in this respect. On the facts of this Article's hypothetical, the matter of controlling Members is not an issue since no single Member has a large enough equity ownership to alone influence the direction of the venture. With respect to Members not currently designated as Managers, this Article posits that to recognize any such Members in the hypothetical as not owing any fiduciary duties, is to put form over substance. This Article suggests that in the nascent venture context, where the facts support an intent to not grant wide swaths of discretionary authority to any one of a small group of co-venturers, that Delaware courts apply the classic maxim of equity to "look to the intent rather than the form."[299]

---

295. *See Feeley*, 62 A.3d at 663.

296. *Id.*

297. *See* Steele, *supra* note 105, at 9-10.

298. *See* Kuroda v. SPJS Holdings, L.L.C., No. 4030-CC, 2010 WL 925853, *7-8 (Del. Chan. Nov. 30, 2010); Marino v. Grupo Mundial Tenedora, 810 F. Supp. 2d 601, 608 (S.D.N.Y. 2011) (applying Delaware law); Kelly v. Blum, No. 4516-VCP, 2010 WL 629850 *12-14 (Del. Ch. Feb. 24, 2010).

299. VGS Inc. v. Castiel, No. C.A. 17885, 2000 WL 1277372, *4 (Del. Chan. Aug. 31, 2000).

2. *Example Of Proposed Writing Requirement In Context Of Venture Party Competing Against Venture*

There are numerous possibilities of venture party actions which might implicate fiduciary duties in the business context, and which could form the basis of a cause of action against an accused party by his or her co-venturers. To illustrate the writing requirement suggested in this Article, the focus is on a very common type of action by venture parties which results in frequent litigation: Venture party members competing against the collaborative venture and/or usurping opportunities of the co-venture.

Continuing with the hypothetical, let us assume for the purposes of analysis in this Article that Delaware deems each of our nascent venture parties as a fiduciary, based on the characteristics and business context of their arrangement. Of course, as discussed, there is a question as to whether Delaware would deem as a fiduciary a Member in our closely-held entity who does not temporally have a title as "Manager," but this Article argues that if Delaware made that determination in the context of our hypothetical that that would be putting form over substance. Further, the dominant theme in this Article is that legal decision-makers require a reasoned foundation on which to base alternative approaches, if those approaches stray from precedent. As one commentator put it, "Recent experience shows that the Delaware courts have been willing to accept truly novel departures from prior law – such as the 'poison pill' or the delegation of the board's authority to a special litigation committee – when they have understood the background context and reasons for the departure."[300]

As stated, in our hypothetical, although the parties eventually executed an LLC operating agreement, they did not include any special language regarding fiduciary duties, choosing to be subject to the default fiduciary duties under Delaware law. Let us assume that the Individual Member in the hypothetical who works professionally as a biomedical researcher[301] (Individual Member B), and who, according to the facts owns a small lab company, decides to compete with the new co-venture. Unbeknownst to the other Members, about 6 months into the co-venture, Individual Member B began developing a drug with the identical prospects to the drug that she and her co-venturers are developing (i.e. drug that shows promise lengthening the average life span of lung transplant patients by 3 years). One of the other Individual Members, described in the hypothetical as a salesperson for a specialty pharmacy[302] (Individual Member A) hears a rumor via his professional network that Individual Member B is negotiating a contract to market the drug that she has secretly developed. When

300. *See* Coffee, *supra* note 67, at 1633.
301. *See supra* Part II.
302. *See supra* Part II.

confronted, Individual Member B states that the drug she has developed has an entirely different chemical configuration than the drug the co-venture is developing, and that anyway, the LLC operating agreement does not prevent her from competing by creating a similar product. The other Members are not happy about this state of affairs and request that Individual Member B discontinue competing with the venture.

Again, we will assume that Individual Member B is deemed a fiduciary, though not currently holding a title as 'manager. In addressing whether Individual Member B has a fiduciary duty not to compete (implicating the duty of loyalty), Delaware would employ a two pronged approach: "Under the first prong, an explicit agreement is enforced according to its terms. However, under the second prong, to the extent that the agreement does not explicitly exclude default duties, the court will apply such duties unless they cannot be reconciled with the terms of the agreement."[303]

First, since the LLC operating agreement does not expressly address Members' rights to pursue competitive opportunities, Individual Member B might argue that she has no contractual restriction on competing with the venture.[304] Presumably as a matter of contract (although not as a matter of fiduciary duty), Individual Member B would be correct.[305] With respect to fiduciary duties, since our nascent venture parties did not include specific language in their LLC operating agreement addressing fiduciary duties, nor exculpatory language sufficient to indicate an intent contrary to the imposition of fiduciary duties, Delaware would most likely analyze this scenario based on default to the traditional fiduciary duties. If decided in line with *Cantor*, it would seem that Individual Member B would not be permitted to compete. However, if a Delaware court did not deem the nascent venture parties as being in a collaborative undertaking similar to *Cantor*, or did not deem Individual Member B a fiduciary, then it is possible Individual Member B would be permitted to compete – but perhaps not using any of the co-venture's proprietary information. It is highly probable that the court would seek a "reasonable default"[306] position, based on a "tailored determination" of what the parties would have wanted in the circumstances.[307] Of course, if Individual Member B is not deemed a fiduciary, then that pushes the court towards permitting her to compete.

What this scenario highlights is that the parties in the nascent venture hypothetical failed to provide the court with enough evidentiary information

---

303. Larry E. Ribstein, *The Uncorporation And Corporate Indeterminacy*, 2009 U. ILL. L. REV. 131, 150.

304. *See Feeley*, 62 A.3d at 657 (similar argument made by defendant in this case).

305. *Id.*

306. *See* Ayres & Gertner, *supra* note 43, at 91-92.

307. *Id.*

in order to more readily decide this case one way or the other. Also, the court has no clear indication from the parties that they carefully thought through their rights and obligations in this transaction; no indication that they carefully considered the implications of their participation in the venture prior to executing the LLC operating agreement. The court could view this as the parties having created a negative externality by pulling in the resources of the court on a transaction that could have been more carefully considered. If extended litigation results in an irrevocable breakdown in the parties' relationship and/or the business venture, then both the court's resources and the human and monetary capital associated with the venture have, to some extent, been wasted. In the situation where the legal decision-maker has adapted an instrumental conception of contract (as opposed to one based on pure autonomy), then avoidance of social waste is an accepted consideration.[308] When the goal is to develop approaches that might incentivize strategic norm development by nascent venture parties, then this instrumental basis for intervening into the parties' private ordering is plausible.

Based on the proposal set forth in this Article, where the nascent venture's LLC operating agreement similarly lacks language addressing the Members' right to compete, it is suggested that the court should decide that there exists no right to compete – since the nascent venture parties did not specifically address the issue. An LLC agreement's lack of clear direction on the right to compete would be an absolute prohibition against it. In any scenario where Individual Member B would like to compete with the venture, even in a very limited manner, she would have to negotiate that with the other Members and it would be required to be set forth in detail in the LLC agreement. In summary, the default standard would not permit competition where the LLC agreement does not expressly provide for it.

While the facts of our hypothetical suggests a scenario where the Members more than likely would be in disfavor of Individual Member B's actions, there could be scenarios where the Members might approve (in advance) Individual Member B's entering into some form of outside, though venture related activity that could prove complementary to their co-venture. In that case, Individual Member B and her fellow co-venturers would have to negotiate, ex ante or ex post, and carve out that space. In that process of give and take, the Members will have to exchange information relative to their interests and concerns regarding the venture and their roles within it. Recall, often the social context in which nascent venturers contract deters them from pursuing the "downside" of a deal, or prevents them from introducing hidden concerns and/or desires they have for the transaction.[309]

---

308. *See* Charny, *supra* note 132, at 432.
309. *See* Coffee, *supra* note 67, at 1677-78.

These parties could be of the view that if they discuss such matters fully and openly, the others might view that discussion as adding complications to the transaction. If the law can play a role as surrogate by nudging individual venture parties to make clearer their intent, then that opens up lines of communication, and may serve to reduce tensions. Further, it is argued that this default approach engenders the venture a more pervasively relational character, supporting privileging of facts that support viewing the venture as a cooperative and collaborative undertaking.

Professor Fuller suggested that "the evidentiary function of legal formalities is to provide information to courts in order to lower the costs of subsequent decision-making."[310] Encouraging the nascent venture parties to more fully explicate their fiduciary rights and duties assists the court in a more efficient determination, ex post, if called upon to resolve a conflict. Additionally, Professor Fuller also argued that "some formalities" such as "certain writing requirements, serve a cautionary function by forcing the parties to undertake a minimal amount of reflection before being bound by a contract."[311]

Now, let us complicate the hypothetical a bit by having our nascent venture parties presume to waive all duties (including fiduciary duties) as permitted under the DLLC Act.[312] To that end, the nascent venture parties in our hypothetical executed an LLC operating agreement with the following provision:

*Performance of Duties; no Liability of Officers*. No Member shall have any duty to any Member of the Company except as expressly set forth herein or in other written agreements. No Member, Representative, or Officer of the Company shall be liable to the Company or to any Member for any loss or damage sustained by the Company or to any Member, unless the loss or damage shall have been the result of gross negligence, fraud or intentional misconduct by the Member, Representative, or Officer in question.

This exact provision was adopted in the *Fisk* case.[313] In *Fisk*, the parties presumed to waive all fiduciary duties by flatly stating (as set forth in the above provision) that the Members have no duties other than those expressly articulated in the agreement. Since the agreement did not expressly articulate fiduciary obligations, the Delaware court determined that no duties were owed.[314]

---

310. *See* Ayres & Gertner, *supra* note 43, at 123-24.

311. *Id.* at 124.

312. *See* DEL. CODE ANN. tit. 6, § 18-1101(c) (West 2013).

313. Fisk Ventures, LLC v. Segal, No. 3017-CC, 2008 WL 1961156, *9 (Del. Ch. May 7, 2008).

314. *Id.*

A court could determine that this provision in the nascent venture parties LLC agreement is a clear and unequivocal expression of intent by the Members to not be bound by fiduciary duties. But again, in the context of the nascent venture hypothetical, has the legal decision-maker been given enough information to confidently arrive at that conclusion? Applied to our previous scenario where Individual Member B commences to compete with the venture, does this provision indicate to the court that the Members intended that they each may compete with the venture? Under the proposal of this Article, the above provision would not be sufficient to waive all duties, and the court would require "course of performance" evidence to decide whether or not the Members intended that they would have the right to compete. Recall, some commentators have suggested that certain provisions in contracts should not be enforced by the courts so that the parties are incentivized to more clearly delineate their rights and obligations, ex ante.[315]

First, even though the nascent venture parties have indicated the no Member shall have any duties, they could have conveyed more information to the legal decision-maker via their exculpation clause. The above provision contains an exculpation clause that does seem to acknowledge a "duty of care," as evidenced by the reference to "gross negligence."[316] Even though this seems to contradict the parties' expression of no duties owed by any Member, it conveys some quantum of information from which a court might glean the parties' intent.

But, can the court credibly determine that the Members had no duty of loyalty (hence, Individual Member B would have a right to compete)? The provision does not even mandate, at a minimum, that the parties act in "good faith," nor does the exculpation clause speak to actions done in "bad faith," thereby injecting some notion of the duty of loyalty. The Delaware Supreme Court clarified the scope of bad faith violations, noting that a failure to act in good faith may be shown for instance, where the fiduciary intentionally acts with a purpose other than that of advancing the best interest of the entity.[317] Inclusion of a good faith standard might have shed light on the right to compete.

It seems that the nascent venture parties have expressed an intent to both waive the duty of loyalty, and not indicate an intent to retain any remedies, equitable or monetary, for violations of the duty of loyalty. Can a court view this expression of intent as credible, or is this an indication that the parties have not thought through the implications of a provision that they purported to have negotiated and agreed to? As this is a nascent venture, should the court demand a minimum indication that the duty of

315. *See* Anderlini, Felli, & Postlewaite, *supra* note 41.
316. *See* ALH Holding L.L.C., 675 F. Supp 2d, 462, 478 n.50 (D. Del. 2009).
317. *Id.* at 478 (citing *In re* Walt Disney Co., 906 A.2d 27, 67 (Del. 2006)).

loyalty was at least discussed relative to some aspects of the duty, rather than a blanket "no duties owed" statement? The fiduciary duty of loyalty has seven (7) subsumed duties under it, including: (1) duty not to compete against the LLC; (2) duty not to usurp LLC business opportunities; (3) duty not to engage in self-interested transactions with the LLC; (4) duty to maintain the confidentiality of confidential information; (5) duty to disclose to the Members certain information; (6) duty to avoid improper personal benefits, including a duty not to use LLC property and other LLC assets as if they were the manager's own assets; and (7) a duty of good faith.[318] If the nascent venture parties had addressed any of these duties in their provision purporting to waive all duties, that would have served an evidentiary purpose for the courts because it conveys that the parties at least considered elements of the duty of loyalty in the context of their venture. After all, to some extent they are competitors, who happen to co-venture together. That fact alone should have pushed the parties to address some matters attendant to their various competitive positions vis-à-vis the company's product. Under the proposal of this Article, nascent venture parties of the type represented by our hypothetical would have to more fully explicate their intentions regarding fiduciary rights and obligations. Not doing so would result in a stronger default to privileging facts that support a narrative of collaborative intent and cooperation, not permitting more self-interested actions. In exchange for the privilege given to freely structure their agreements, Delaware courts should insist that parties exercise that freedom wisely. The burden is that parties will have to show the court that its intervention is not required to rectify a deficiency in planning. Deficient planning results in inefficiencies, and wasted resources.

## VI. CONCLUSION

When legal decision-makers seek to use the law in an instrumental fashion, such as in developing approaches and/or methodologies to influence the cultivation of strategic norms, they require a reasoned framework to justify intervention in this way. When the institutional arrangement is the entrepreneurial venture, legal decision-makers must have a comprehensive understanding of the environment in which such institutions operate in order to develop policies and approaches deemed legitimate, and having a basis in legal precedent and/or accepted tenets of jurisprudence. Where the prescription is to incentivize the disclosure of certain private information in order to endogenize cooperation, we see that legal decision-makers must navigate through a myriad of legal and social factors, including alternate conceptions of contract, and behavioral factors

318. *See* RIBSTEIN & KEATINGE, *supra* note 90.

impacting private parties' decision-making processes. The preliminary analytical framework offered in this Article is an insight into legal evolution and jurisprudence, generally, but as applied in the real world context of contractual relations of business parties in the entrepreneurial space, specifically.