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Gap Fillers and Fiduciary Duties in Strategic Alliances

By George W. Dent, Jr.*

Strategic alliances—including joint ventures, franchises, dealerships, distributorships, licensing arrangements, and "strategic investments"—are nothing new; they have existed for centuries. In recent years, though, they have proliferated and their importance has mushroomed because of economic and technological changes. Alliances now "account for more than 20% of the average large firm's revenues." This growth is not surprising because most strategic alliances are profitable. We are witnessing not quite the birth but certainly the ascent of an entity (or, more precisely, a related group of entities) distinct from both traditional business entities (corporations and partnerships) and from newer entities like the limited liability company.

This ascent challenges the law. The central task of the law of business associations is to establish gap fillers (or default rules) and fiduciary duties for relations among their owners. How well the law meets this challenge deeply influences economic growth.

This Article describes the evolution of strategic alliances and their dependence on trust between the allies. It then discusses the general theory of gap fillers and

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1. Steven I. Glover, Negotiating and Structuring Joint Ventures: Lessons from Management Consultants, M & A LAWYER, Mar. 1998, at 1, 4 (predicting this figure to be attained by the year 2000 and noting a twenty percent annual increase in the value of strategic alliances involving Fortune 1000 companies in recent years).

2. Id. at 4 (reporting that "the return on joint venture investments is 17 percent," which is "higher than the rate of return on other corporate activities"); see also Su Han Chan et al., Do Strategic Alliances Create Value?, 46 J. Fin. Econ. 199, 209-13 (1997) (showing that stock prices of both partners usually rise following announcement of a strategic alliance).

3. See infra notes 94-98 and accompanying text. The law of business organizations also sets default rules for liability of organizations and their owners to third parties. Professor Ribstein proposes recognition of a new class of business association—the "contractual entity"—whose owners would enjoy limited liability to creditors of the entity, as do corporate shareholders. Larry E. Ribstein, Limited Liability Unlimited, 24 DEL. J. CORP. L. 407, 435-46 (1999). This "contractual entity" would include many strategic alliances that would not be categorized as partnerships, corporations, or limited liability companies. Id.

4. Thus in comparing the economic performances of different nations, John Coffee concludes that "law matters." John C. Coffee, Jr., Privatization and Corporate Governance: The Lessons from Securities Market Failure, 25 J. CORP. L. 1, 1 (1999). That is, the law of business associations and securities regulation "can somehow better promote economic efficiency than can reliance on financial contracting alone." Id. at 4. Certain legal systems outperform others in this regard. Id. at 2.
fiduciary duties and the inevitability of major gaps in strategic alliance contracts. Finally, it combines these elements to derive conclusions about the proper role of gap fillers and fiduciary duties in strategic alliances.

STRATEGIC ALLIANCES AND THEIR PROLIFERATION

WHAT ARE STRATEGIC ALLIANCES?

"Strategic alliance" is a business term. Business lawyers use it by necessity, but it has no legal definition. It has been described as an arrangement "whereby two or more firms agree to pool their resources to pursue specific market opportunities." This Article will use a slightly narrower definition of strategic alliance as a sustained relationship in which the agreed performance of each party is complex and largely autonomous and each party has a profit interest. The vagueness of this description is inevitable if artificial lines are to be avoided.

The archetypal strategic alliance is the joint venture. In law, a true joint venture is usually treated as a general partnership except that it generally connotes a single project rather than a broad, continuous business relationship. Unlike most partnerships, most joint ventures have business associations rather than individuals as members. The joint enterprise is often incorporated, in which case it is called a "joint venture corporation" and is legally a corporation, not a partnership.

The legal status of strategic alliances other than joint ventures—including manufacturing and distribution arrangements (franchises, dealerships, and licenses), and strategic investments—is often unclear. "The receipt by a person of a share of the profits of a business is prima facie evidence that he is a partner in the business . . . ." Although a franchise, for example, may entail sharing of

5. Ranjay Gulati, Does Familiarity Breed Trust? The Implications of Repeated Ties for Contractual Choice in Alliances, 38 ACAD. MGMT. J. 85 (1995); see also ALAN S. GUTTERMAN, CORPORATE COUNSEL'S GUIDE TO STRATEGIC ALLIANCES 1.001 (1997) (referring to a "process of accessing" complementary assets and resources of two or more firms "in order to efficiently and rapidly implement the innovation process").

6. Allies need not share profits from a single pool. In a dealership, distributorship, franchise, or licensing agreement, for example, each party seeks profit, but not from one pool. This definition omits some arrangements that fall under the definition used by Gulati, as when one firm performs research for another firm for a fee rather than for a profit interest. See Gulati, supra note 5.

7. In both the Unif. Ps'hip Act (1914) § 6(1), 6 U.L.A. 256 (1995) and Unif. Ps'hip Act (1994) § 101(6) (amended 1997), 6 U.L.A. 37 (Supp. 2001) "partnership" is defined as "an association of two or more persons to carry on as co-owners a business for profit. . . . " [T]he joint venture, if distinguished from a partnership at all, must be categorized as a business association similar to the partnership but more narrow in purpose and scope." HAROLD GILL RESCHELIN & WILLIAM A. GREGORY, THE LAW OF AGENCY AND PARTNERSHIP 451 (2d ed. 1990) (footnote omitted); see also 1 RICHARD D. HARROCH, PARTNERSHIP & JOINT VENTURE AGREEMENTS § 2.09(2), at 2-73 (1992); GUTTERMAN, supra note 5, at 11.001-.035.

8. HARROCH, supra note 7, at 2-75.

9. For a discussion of these arrangements see GUTTERMAN, supra note 5, at 8.001-.058, 10.001-.031; see also Charles T.C. Compton, Cooperation, Collaboration, and Coalition: A Perspective on the Types and Purposes of Technology Joint Ventures, 61 ANTITRUST L.J. 861, 864-68 (1993) (listing different types of alliances).

10. For a discussion of strategic investments see GUTTERMAN, supra note 5, at 12.001-.027.

profits, in general a franchisor is not a co-owner of the franchise. If a franchisor de facto controls the franchisee, however, the latter may be deemed the agent of the former, who then is liable for the debts of the franchisee. 12

Unlike corporations, alliances are not government chartered; and unlike partnerships, they have no statutory definition, so the boundaries of the definition are hazy. When, for example, does an investment by one company in another become a "strategic investment" worthy to be called an alliance? A major equity stake and close cooperation between the investor and the issuer are not enough; these features are common in venture capital investments that are not considered strategic alliances. The investor's further interest as a current or potential customer or potential acquirer of the issuer is needed. 13

Strategic alliances often involve international trade, or high technology research and development, or both. In the past most distribution agreements involved parties of very different sizes performing separate functions. Duties could usually be fairly well defined by contract and each performance could reasonably be monitored by the other party so that breaches could be fairly easily detected. The victim of a breach could then sue for damages or terminate the contract and seek a substitute contract with another party. If a hamburger franchisee performs poorly, for example, the franchisor with a nationwide chain can cancel the franchise and quickly find a new franchisee.

As the word "alliance" suggests, strategic alliances tend to involve closer cooperation and parties of more equal size. 14 The goals of alliances (like developing new technology or promoting a product in a foreign market) require inputs (like research or marketing skill) that are harder to define and to monitor than in more traditional relational contracts. Contracts are, therefore, harder to draft and breaches harder to detect and prove in strategic alliances.

In the past these problems were addressed by integrating the needed inputs within a firm. 15 Strategic alliances involve situations where this solution will not work. If a domestically-owned firm is needed by a foreign company to enter a national market, acquiring the domestic firm would eliminate its domestic ownership. A company that needs some technical skill may not need the skill providers full-time for an indefinite period. By entering into strategic alliances, the skill providers can benefit many partners rather than being employees of just one. When an alliance ceases to be profitable (perhaps because a discrete project has been completed), it is terminated; the skill purchaser need not divest assets or fire employees. Skill providers often prefer to remain independent within an alliance with a firm rather than becoming employees of the firm both for psycho-


14. See Glover, supra note 1, at 3 (stating that fifty-fifty joint ventures tend to be more successful).

15. Ronald Coase first argued that firms exist to overcome the problems of trading in markets. Ronald Coase, The Nature of the Firm, 4 ECONOMICA 386, 392 (1937); see also infra notes 27-28 and accompanying text (discussing asset specificity).
logical reasons and because it is easier to devise effective incentive compensation in a small firm than in a large firm. 16

Firms in an alliance are also more likely to come from different industries than the parties in more traditional relational contracts. In the past, firms in different industries generally dealt with each other through sales contracts, but ordinary sales contracts are often inadequate where close cooperation is needed to integrate or develop sophisticated information or technology. Relationships are more complex when the parties come from different industries. The cultures of the two industries may differ in many respects, including contracting conventions. 17

For all the above reasons strategic alliances depend on mutual trust more than do people in a firm or parties to a sales contract. Because alliances require closer cooperation than ordinary sales contracts but lack the hierarchy of a firm, each side is vulnerable to opportunism by the other. And because a party’s duties often involve specialized skills, it may be hard for the victim of a breach to find a substitute partner. For all these reasons there is a greater need for courts to fill gaps in the contract and to curb opportunism with fiduciary principles in strategic alliances than in other relationships.

WHY DO STRATEGIC ALLIANCES EXIST?

Strategic alliances pose a paradox: under classic financial theory, they should not exist. In theory, business is transacted either in markets or in firms; 18 a firm chooses to “make-or-buy” each input it needs. 19 Strategic alliances fit neither category. 20 Recognition of a third mode of business activity is not entirely new. Commentators have long noted the existence of long-term “relational contracts” that differ markedly from the single-transaction contracts that markets comprise, but whose parties are independent rather than integrated within a firm. 21

In some ways strategic alliances are relational contracts: both are long-term transactions between independent parties. Alliances, however, so differ from traditional “relational contracts” that it is misleading to give them that label. The classic relational contract is an on-going sales arrangement between a customer

16. See JOSEPH L. BADARACCO, JR., THE KNOWLEDGE LiNK: HOW FIRMS COMPETE THROUGH STRATEGIC ALLIANCES 104 (1991) (merging a smaller firm into a larger may eliminate the "independence, and entrepreneurship on which a \[smaller\] firm’s special capabilities rest.").
17. Even in the same industry companies from different countries may opt for an alliance over a merger because of different cultures. See Bengt Holmström & John Roberts, The Boundaries of the Firm Revisited, 12 J. ECON. PERSP. 73, 84 (1998) (referring to alliances between airlines from different countries).
18. See, e.g., OLIVER E. WILLIAMSON, MARKETS AND HIERARCHIES: ANALYSIS AND ANTITRUST IMPLICATIONS (1975) (discussing the division of business activity between firms (which he calls “hierarchies”) and markets).
19. See Gulati, supra note 5, at 86.
20. See Ribstein, supra note 3, at 414 (“[T]here is a continuum of ‘firm-ness’ rather than a strict dichotomy between firms and non-firms. . . . The franchise contract is a classic example of a hybrid of firm and non-firm.”) (footnotes omitted).
and a supplier; each performs a distinct function in the chain of production. In most alliances the parties’ relationship is more symbiotic. In a research and development joint venture, for example, the partners combine strengths in different technologies to create a new product. Although the line between the two is not always clear, strategic alliances usually entail a more complex undertaking and closer cooperation and integration of activity between the parties. Strategic alliances, however, can also be tailored to limit collaboration so that even competitors can cooperate. For instance, a consortium of auto manufacturers worked together in order to reduce auto pollution more quickly and cheaply than they could have separately while they still competed in sales.

The distinct features of alliances are dictated by the parties’ pursuit of goals that they cannot achieve as well in ordinary sales or in a firm. Sales contracts are not well suited, for example, for transfers of confidential information. They require a seller to fully reveal the product to a potential buyer. With confidential information that is impossible because once the information is disclosed, the transfer has already occurred. An arrangement in which the seller accepts a share of the profits from the use of information is preferable because it offers the buyer some assurance of the value of the information. Market transactions are also problematic when the required performance is so vague, complex, or dependent on future uncertainties that it cannot be precisely specified in a contract.

Finally, markets work poorly for undertakings that require “team production”—that is, projects requiring several members, each of whom will “make an irrevocable commitment of resources to the joint enterprise.” Such a “relation-specific” investment may be of a capital asset. One who makes such a commitment is vulnerable to hold-up: the other party may refuse to pay an adequate price for use of the asset, and the owner cannot then seek another user because the asset is relation-specific.

22. See id. at 1095.
24. See Jean-François Hennart, A Transaction Costs Theory of Equity Joint Ventures, 9 STRATEGIC MGMT. J. 361, 365 (1988) (“If the seller were to provide that information in order to educate the buyer on the value of the know-how for sale, he would, by revealing the information, be transferring the know-how free of charge.”) (citation omitted). “[M]erely informing a potential buyer about one’s product gives away a great deal of the benefit. Hence, information is shared alongside sheaves of nondisclosure agreements, and, even then, there is selective hiding of critical components.” Richard J. Zeckhauser, The Challenge of Contracting for Technological Information, 93 PROC. NAT’L ACAD. SCI. USA 12,743, 12,744 (1996), quoted in Karen Eggleston et al., Simplicity and Complexity in Contracts 17-18 n.53 (Jan. 18, 2000), available at http://www.law.uchicago.edu/Publications/Working/index.html (unpublished manuscript); see also Steven R. Salbu & Richard A. Brahm, Strategic Considerations in Designing Joint Venture Contracts, 1992 COLUM. BUS. L. REV. 253, 272 (1992) (stating that technology joint ventures “often involve the use of organizationally embedded knowledge or sophisticated technology that is difficult to exchange efficiently through arms-length market mechanisms”) (footnote omitted). Mere disclosure is not always the sole objective, though. For example, a buyer may know all about a patented device but need the permission of the patent holder to use it.
25. See WILLIAMSON, supra note 18, at 20-24, 75.
27. See Holmström & Roberts, supra note 17, at 74.
28. "The more specialized the investment, the lower its value in its next best use. This heightens
Consider, for example, a McDonald's restaurant. Its value is enhanced by exhibiting brand signs and symbols (like the golden arches) well known to customers, but a full display of these signs and symbols is expensive. If a restaurant owner purchases them, McDonald's could promptly forbid her to use the McDonald's name and then offer to buy the restaurant for far less than its cost. Whether or not she accepts, the owner suffers a large loss. The owner's investment (including costs of advertising and other marketing efforts) can also be damaged if McDonald's approves a competing restaurant next door to it. To avoid such opportunism franchisees seek assurance that their franchises will not be arbitrarily canceled and will enjoy some protection from competition.

A reputation for quality may increase a manufacturer's profits, but to achieve and retain this reputation it must ensure quality at the distribution level. To do so, a manufacturer may sell through franchisees who maintain its standards. Thus, the manufacturer can get better distribution with a limited number of franchisees than by selling to anyone who will buy its products.

Many projects need a long-term commitment of brain-power from one or many people. This need complicates the exchanging of information: when knowledge is "embedded in the individual possessing it[,] . . . its exchange must rely on intimate human contact." Commitments of firm-specific human capital face the same danger as commitments of tangible assets, though. That is, one who develops skills useful to only one project is vulnerable to the opportunism of the party who hires those skills.

In such cases parties may create a firm—i.e., "a team use of inputs and a centralized position of some party in the contractual arrangements of all other inputs." Diseconomies of scale limit the size of firms, though. In larger firms it is harder for managers to gather and digest information and to offer optimal incentives to employees, especially employees who perform sophisticated tasks that others cannot easily monitor. Whether these problems make a hierarchy (i.e., firm) unsuitable depends on the size of the project and the kind of inputs it needs. It may also depend on the participants' skill in devising an alliance that is more efficient than a firm for the project.

The limitations of market transactions and of firms define the range of situations in which strategic alliances are the most efficient solution. They offer economies the risk of opportunistic behavior . . . . " Thomas M. Palay, Comparative Institutional Economics: The Governance of Rail Freight Contracting, 13 J. LEGAL STUD. 265, 266 (1984); see also Hennart, supra note 24, at 367 (discussing use of franchises where "distribution requires substantial up-front investments"); see generally Peter Lorance & Johan Roos, Strategic Alliances: Formation, Implementation and Evolution 207 (1992) (discussing sunk costs of dealers and franchisees).


30. Hennart, supra note 24, at 366.


33. See supra note 16 and accompanying text.
of scale that cannot be realized through market transactions. Alliances typically involve transfers of knowledge and commitments of major assets, especially human capital, that are not well suited to market exchanges. If, for example, Zilchco wants widgets of a quality that is widely available, a purchase contract with a manufacturer is probably the best way to obtain them. If, however, Zilchco needs a new, improved widget, and if cooperation between Zilchco and a producer can help to develop the new widget, it may be impossible to spell out in a purchase contract what each party should do and receive under all possible contingencies and then to confirm whether each party has fully performed.

Integrating two firms by a merger may not be optimal, either. If widgets are only part of the manufacturer's output, a merger may lead to inefficiencies in other products which Zilchco does not understand. The two companies may also have different cultures that would clash after merger. Of course, the same problem may infect a strategic alliance between the two firms, but in that case the problem is limited to the joint project.

In such cases two parties can create a joint entity in which both share profits but which is controlled by one party, but that party could exploit control to reduce the return to the junior partner. If instead the junior receives a guaranteed return for its input, it has an incentive to shirk in its efforts. If the junior's performance is hard to define and monitor, the controlling partner may then be unable to prove a contractual breach by the junior. Therefore, the best arrangement in such cases may be neither market exchanges nor a firm subject to the control of only one party, but instead an arrangement in which the parties share both control and profits—i.e., a strategic alliance.

For example, franchises, dealerships, and distributorships are often used where a supplier could not easily monitor an employee managing a distribution outlet. Unlike an employee on salary, a franchisee can assume much of the risk of success or failure of the outlet. The resulting incentives substitute for monitoring by the

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34. See Hennart, supra note 24, at 363 (describing use of joint ventures to achieve economies of scale).
35. Id. at 371 (joint venture often used if a merger “would force the acquirer to enter unrelated fields or to suddenly expand in size, with the attendant management problems”); BADARACCO, supra note 16, at 105 (same).
36. See BADARACCO, supra note 16, at 67. These problems are additional to the problems that always confront mergers, such as what to do with two sets of managers when only one is now needed.
37. “[F]ranchising is usually undertaken in situations where the franchisee is physically removed from the franchisor, and thus where monitoring of the performance and behavior of the franchisee would be difficult.” Rubin, supra note 29, at 226. For example, it may be hard for a franchisor to detect that a franchisee is free-riding on the efforts of the franchisor and other franchisees by skimping on service to customers. See Benjamin Klein & Kevin M. Murphy, Vertical Restraints as Contract Enforcement Mechanisms, 31 J.L. & ECON. 265, 270-76 (1988). The franchisee may also know important local information that the franchisor lacks, such as the best location for an outlet, optimum hours of operation, and the performance of employees. Id.
38. “[W]e would expect the franchise contract to be written in such a way as to give the franchisee much of the profits in the operation.” Rubin, supra note 29, at 226; see also James A. Brickley & Frederick H. Dark, The Choice of Organizational Form: The Case of Franchising, 18 J. Fin. ECON. 401, 405 (1987) (ascribing use of franchises to the strong incentives they give franchisees to maximize profits); Holmstrom & Roberts, supra note 17, at 87-88 (same). The franchisee’s substantial investment in the franchise bonds its commitment to work hard. Id.
supplier. Even where a merger may make sense, the parties may refrain because of initial uncertainty about each other. A strategic alliance may serve as a trial cohabitation to resolve their doubts about whether to marry. 39

The nature and function of alliances become clearer if we view markets and firms not as distinct categories but as parts of a continuum of contracts. In this view "[t]he private corporation or firm is simply one form of legal fiction which serves as a nexus for contracting relationships." 40 This taxonomy eschews a view of markets, alliances, and firms as uniform within each category and unrelated to other categories. Rather within each category arrangements vary; some resemble certain arrangements in other categories more than some arrangements in their own category. For example, a joint venture may be more similar to a firm than it is to a distributorship, even though joint ventures and distributorships are both labeled strategic alliances.

The "nexus of contracts" taxonomy may be misleading in some ways, though. Contracts in spot markets generally trigger no fiduciary duties and involve little trust between the parties. Firms are different in both respects. Treating both firms and market transactions as contracts may blind us to the different expectations that parties have in different arrangements, differences to which the law should pay heed.

Strategic investments can facilitate project financing. Debt financing is unsuitable for a firm that is a high risk or whose assets are mostly firm-specific so that they could not be seized and sold by a creditor after default. 41 Public equity financing is unavailable for firms whose capital needs are too small to justify the costs of a public stock offering. The only remaining option is private equity financing, which entrepreneurs often obtain from venture capitalists. A small firm, however, may prefer to raise money from a larger firm in its industry. The large industrial firm may offer better technical and marketing advice and other assistance. A large firm in the same industry may also understand the small firm's technology and commercial prospects better than a venture capitalist does. 42 The two firms may also have a customer-supplier relationship that is strengthened by the large firm's investment in the smaller. Finally, an investment may help the parties get acquainted and decide if they wish to merge. 43 Despite these advantages of alliances, we will see that they also pose some dangers, and the magnitude of those dangers depends in part on how alliances are treated by the law.

CAUSES OF THE PROLIFERATION OF STRATEGIC ALLIANCES

Several factors have combined to cause a proliferation of strategic alliances. Extensive integration of firms fell from favor, but the need grew for greater co-

39. See Glover, supra note 1, at 8 (stating that a strategic alliance allows a potential purchaser to "decide in a methodical, careful way whether it wants to make an acquisition").
41. See Hennart, supra note 24, at 368-69 (describing use of joint ventures where debt financing is not feasible).
42. See Gutierrez, supra note 5, at 12.001.
43. See id. at 12.023-024.
ordination of production than market transactions could offer. Meanwhile, the
ability to draft strategic alliance contracts to meet this need improved. These
developments warrant discussion.

During the 1960s and '70s many companies expanded, often through acqui­sitions. Three justifications were given for firm growth. First, expanding a com­pany's existing lines of business generated economies of scale; many equated
bigness with efficiency. Second, if a firm added new lines of business that were
related to the old, it could realize efficiencies through better coordination of the
two lines than is possible in market transactions between separate firms. Third,
even if the new lines were unrelated to the old (i.e., "conglomerate" growth),
profits could be increased through improved management. Many claimed that
managerial talent was unitary; it mattered not whether the firm produced sausages
or advertising campaigns.

It is unclear whether people making these claims (especially the last) really
believed them or merely used them as pretexts for growth that benefitted man­agers personally but not shareholders. In any case, it is now generally conceded
that different knowledge and skills are needed to manage different kinds of busi­nesses. Combining different lines of business in one company is more likely to
diminish than to increase profits.

Further, economies of scale and coordination do not increase infinitely but
decline after some point. As a firm grows it gets harder, not easier, for managers
to gather and digest all material information. Diseconomies of scale are even
more common under modern technology: "the large factories of the past are being
replaced by smaller-scale, more flexible technologies . . . ." One reason for this
is the growing importance of knowledge, or human capital: "because of advances
in information technology, agents who were previously engaged in routine tasks
need to be motivated to make wise decisions on the basis of the increasing amount
of information at their disposal." It is easier in smaller, specialized firms than in
huge conglomerates to motivate agents by closer monitoring and by offering comp­ensation schemes that reward good work. The acceleration of change also dis­favors integration because it is often faster to access the skills of another firm than
to develop it from scratch on one's own.

44. See JOHN KENNETH GALBRAITH, THE NEW INDUSTRIAL STATE 2-6 (1967) (arguing that firm
growth benefits managers); FRANCIS FUKUYAMA, TRUST: THE SOCIAL VIRTUES AND THE CREATION OF
PROSPERITY 201 (1995) (stating that as a firm grows "the firm's bureaucracy develops a stake in its
own survival rather than profit maximization").
45. See Bob Tedeschi, What's That Noise on the Internet? The Sound of Alliances Being Forged, N.Y.
TIMES, June 7, 2000, at H25 (stating that companies now "don't want to be the jack-of-all-trades").
46. See Alchian & Demsetz, supra note 32.
48. Id.; see generally William G. Ouchi, A Conceptual Framework for the Design of Organizational
Control Mechanisms, 25 MGMT. SCI. 833 (1979) (discussing the problems of a hierarchical firm when
a person's performance is difficult to define by contract and to evaluate).
49. See BADARACCO, supra note 16, at 140-43.
50. See Tedeschi, supra note 45 (stating that "stopping to develop expertise in any given area is
tantamount to suicide").
Large firms make sense only when they control significant non-human assets, as in "smoke stack" industries. Firms without significant non-human assets tend to be unstable. Tangible assets, like a mine or a factory, are usually difficult to share among several users. The knowledge and skill of an individual or a team can be shared by several users, though, so there is less need to put this asset under the control of a single user. New technologies require less capital investment. The increasing importance of human capital, therefore, abets the proliferation of smaller, more specialized firms. Economic globalization also aids this trend. The global market is large enough to support firms that are too specialized to survive in any national market. As a result there has been movement in recent years away from industrial integration and toward specialization.

At the same time, globalization increases the need for cooperation. More companies want to sell their products in foreign countries, but because of protectionist laws and a company's ignorance of a foreign market it may need a local partner to help with sales in that market. Globalization also subjects many companies to increased foreign competition at home. To meet growing competition, many firms seek additional inputs (especially technology), but integration often is not best way to obtain these inputs, for the reasons just discussed.

Spot market transactions are not always optimal for this purpose. Spot markets work well for commodities whose features and price are well established. These conditions rarely exist for technology and human capital. Often a seller cannot disclose the nature of the product because the disclosure itself is what the buyer wants. Also, technology is valuable only if it is rare; there is no reason to pay for it if equivalent technology is freely available. But markets set prices only for fungible goods, so there cannot be a market price for a unique item. Further, there cannot be a sale of technology that does not yet exist. To develop new technology, some other arrangement is needed.

Trading human capital in spot markets is even more problematic. Humans cannot be bought and sold. They can be hired temporarily without becoming employees, but this solution does not work when a person's services are needed for a long time. Further, many tasks are too complicated to be handled by one person and must be tackled by a team. Large team projects (like major building construction) can sometimes be achieved through ordinary contracts with firms. Many projects, though, are too complicated to be specified by ordinary contracts.

In theory these trends lead to the virtual corporation: a firm with no employees beyond a management team and no assets beyond what this team needs to func-

52. See id. at 58-59.
53. See id. at 53.
54. See id.; Claudia H. Deutsch, Clearing Out the Kitchen Sink: Conglomerates Learn to Pick Their Spots, N.Y. Times, July 29, 1997, at D1 (describing the trend of deconglomeration). This trend outweighs the simultaneous proliferation of mergers. Moreover, in recent years there have been fewer conglomerate mergers. At least in horizontal mergers, firms become larger but not more integrated, so that the surviving firm may need external outputs as much as the constituent firms did.
55. See Hennart, supra note 24.
tion. This management team contracts for all of the firm's other inputs. The virtual corporation, then, epitomizes the concept of the firm as a legal fiction, a mere nexus of contracts. The virtual corporation's potential is limited because its dependence on market exchanges makes it "inherently more adversarial, more non-cooperative, than is the traditional vertical structure." Strategic alliances can overcome this problem by being more cooperative without incurring the problems of the integrated firm.

Strategic alliances have also grown because better contracts are available, aided by the increasing experience of many lawyers, the publication of treatises, and the creation of training programs for lawyers. The expansion of business fosters higher expertise through greater specialization among lawyers. Word processing, facsimile transmission, electronic mail, computer-assisted research, and duplicating equipment have facilitated the drafting and negotiation of better contracts.

These same forces also facilitate alliances by improving the exchange of information and, thus, coordination between partners.

**TRUST IN STRATEGIC ALLIANCES**

**TRUST IN BUSINESS TRANSACTIONS**

At first blush trust may seem too naive a concept for the hard, cold world of business. As Oliver Williamson says: "Indeed, I maintain that trust is irrelevant to commercial exchange and that reference to trust in this connection promotes confusion." However, social scientists now widely agree that trust is essential to the successful functioning of business and of society generally.

Trust is most obviously important in individual relationships. Spouses could never fully specify their duties in a contract and then monitor each other's compliance. Doing business with friends and relatives whom one can trust offers clear advantages. In many societies most business is conducted within such relation-
ships. In the global, technologically sophisticated modern economy, though, trust must be broader.

The order of law alone, it has come to be pretty clear, is not enough in itself to sustain a market economy: a capitalist system also requires what might be called an order of custom—a cultural infrastructure of norms, learned dispositions to respect property and keep promises and pay taxes and refrain from private violence to settle disputes, and of a certain degree of mutual trust—confidence that others will, within limits, for the most part, also respect the norms. The law without the custom supporting it doesn't work, because no legal system can maintain order against persistent and pervasive violations or evasions. Yet custom also needs the support of the law: the custom without the law doesn't work either, because norms of cooperation and mutual trust create openings for opportunists and free riders to abuse them, and outside of close-knit communities nonlegal social sanctions will not adequately police against such abuses.

In an observation that is obvious yet striking Francis Fukuyama notes that no one relies solely on contract; no one will contract with a person who threatens to cheat on and breach a contract whenever it benefits him to do so. Indeed, contract law does not honor provisions eschewing the duty to act in good faith because no reasonable person would agree to such a term.

Trust reduces transaction costs: "there is less need to spell things out in lengthy contracts; less need to hedge against unexpected contingencies; fewer disputes,

63. See Fukuyama, supra note 44, at 78-79 (describing grounding of business relationships in China on family connections).
64. Trudy Govier, Social Trust and Human Communities 24 (1997) (stating that modern trust ties "more to people's sense of how institutions operate than to their attitudes towards unknown individuals"); id. at 29 ("To live in a complex society without going mad, we must have trust in systems too.").
65. Robert W. Gordon, Why Lawyers Can't Just Be Hired Guns, in ETHICS IN PRACTICE: LAWYERS' ROLES, RESPONSIBILITIES, AND REGULATION 42, 44 (Deborah L. Rhode ed., 2000). Norms like trust "often precede laws but are then supported, maintained, and extended by laws." Robert Axelrod, The Complexity of Cooperation: Agent-Based Models of Competition and Cooperation 60 (1997); see also Tamar Frankel, The Legal Infrastructure of Markets: The Role of Contract and Property Law, 73 B.U. L. Rev. 389, 389-90 n.3 and accompanying text (1993) (arguing that markets require a legal infrastructure, or else they will fall into abuse and non-use). Many commentators now use the concept of "social capital," which has been defined as the "social networks and the norms of reciprocity and trustworthiness that arise from them." Robert D. Putnam, Bowling Alone: The Collapse and Revival of American Community 19 (2000). Appreciation of the economic importance of culture, though, goes back at least to Max Weber. Weber stood Karl Marx on his head by arguing that it was not underlying economic forces that created cultural products like religion and ideology but rather culture that produced certain forms of economic behavior." Fukuyama, supra note 44, at 43-44. Social capital strengthens supplier relations, regional production networks, and interfirm learning, thereby reducing transactions costs. Paul S. Adler & Seok-Woo Kwon, Social Capital: The Good, the Bad, and the Ugly 3, 6, 11, 17 (1999) (unpublished manuscript, on file with The Business Lawyer, University of Maryland School of Law).
66. See Fukuyama, supra note 44, at 25.
67. See U.C.C. § 1-102(3) (2000) (stating that the duty of good faith may be modified only by an agreement that is not "manifestly unreasonable").
and less need to litigate if disputes arise." 68 Conversely, "where trust is gone . . . the agency costs incurred by the team members—the costs of mutual monitoring if you will—are likely to increase." 69 Rail freight contracts often include terms that are unenforceable under government regulations because the parties want "to reinforce shipper’s ‘moral commitment.’" 70 Similarly, in enhanced customer-supplier relationships, it is important to have "a set of ground rules that generates trustworthy transactions." 71

The importance of trust varies from contract to contract. Little trust is needed in sales of tangible goods whose worth can be gauged by immediate investigation. Such exchanges are common even among strangers in primitive cultures. Trust is more important when the value of the commodity exchanged is not so apparent. Thus "[o]penness is paramount in knowledge links." 72 Such commodities are of growing economic importance. Trust is also important in bargains for future performance, especially if one party will perform before receiving the agreed consideration. Finally, trust is crucial in transactions so complex that the duties of each party cannot be fully spelled out. 73

Trust can build over time. "[I]ndividuals begin cooperative exchange relationships at low levels of exchange. As partners fulfill their exchange obligations, cooperation rises to higher levels." 74 Transacting parties often follow a 'tit-for-tat' strategy in which parties mimic the behavior of their counterparts. Under this strategy, initial cooperation is likely to induce cooperation by others. 75 Similarly, Stewart Macaulay found that in on-going sales relationships "[d]isputes are frequently settled without reference to the contract or potential or actual legal sanctions." 76 Not surprisingly, then, partners in strategic alliances are exhorted to "begin with small trial efforts at collaboration" to see whether they are compatible. 77 Similarly, joint ventures work best for parties who contract repeatedly because each wants to maintain the other’s trust and thereby increase the likelihood of continued dealings. 78

68. Fukuyama, supra note 44, at 151; see Oliver E. Williamson, The Modern Corporation: Origins, Evolution, Attributes, 19 J. ECON. LITERATURE 1537, 1545 (1981) ("Ubiquitous, albeit incomplete, contracting would . . . be feasible if economic agents were completely trustworthy.") (emphasis added).
70. Palay, supra note 28, at 276.
72. BADARACCO, supra note 16, at 142.
73. See infra notes 157-58 and accompanying text (discussing complexity as a cause of incomplete contracts).
77. BADARACCO, supra note 16, at 141.
78. See Gerald T. Garvey, Why Reputation Favors Joint Ventures over Vertical and Horizontal Integration:
Although trust and cooperation are mutually beneficial it is hard to contract for them. Parties may agree, say, to "cooperate fully," but such terms are vague. Parties can be more specific and repeatedly revise their contract, but frequent revision is expensive; trust reduces costs by reducing the "need to spell things out in lengthy contracts." Therefore, partners often do not amend the contract even as trust and cooperation increase. "Norms of cooperation and mutual trust create openings for opportunists...to abuse them," however, and the greater the trust, the more vulnerable the entrustor is to opportunism.

Strategic alliances are particularly susceptible to opportunism. When Macaulay said business people often settle disputes "without reference to the contract or potential or actual legal sanctions[,]" he referred to people who repeatedly contract with each other in a tightly knit industry. In these circumstances one jeopardizes one's contractual relations and reputation by flouting industry norms, even if one complies with the literal terms of a written contract or might otherwise prevail in litigation. Some strategic alliances are formed in close-knit industries. In these cases courts should defer to industry norms.

Most alliances are not between firms in close-knit industries, but courts should still supply them with gap-fillers and fiduciary duties. If courts enforce only literal contract terms, parties must draft expensive contracts covering every detail and contingency. Firms already in alliances will tend to be suspicious, to monitor their partners constantly, and to be grudging in their own performance because they can count on no more in return.

The possibility of growing trust complicates legal analysis. Courts interpreting a contract try to discern the intentions of the parties, but their intentions (and, accordingly, their duties) may evolve through their course of dealing. Parties can record revised intentions by amending their contract, but often they do not. Some changes of intent are evident and specific, but with trust and cooperation change is almost necessarily vague and amorphous. If courts ignore unrecorded changes of intent, the temptation of opportunism and the danger of relying on trust (rather than frequent, costly rewriting of contracts) both increase. "Without trust, there will be a strong incentive to bring...activities in-house and restore the old hierarchy." Integration, however, is not always efficient. Thus, a lack of trust between contracting parties can diminish efficiency.

A Simple Model, 28 J. ECON. BEHAV. & ORG. 387, 391 (1995) (stating that "joint venture type arrangements...are more likely to be chosen when the relationship is repeated").

79. See GUTTERMAN, supra note 5, at 117.032 (discussing the sample contract term to "cooperate fully").

80. See HART, supra note 47, at 25 (discussing that contract renegotiation is costly).

81. See Gordon, supra note 65 and accompanying text.

82. Macaulay, supra note 76, at 61; see also Hofmström & Roberts, supra note 17, at 80 (discussing industries that feature "long-term, close relations with a limited number of independent suppliers that seem to mix elements of market and hierarchy").


84. Under the U.C.C. the "agreement" to be interpreted is defined not only from the parties' language but also "by implication from other circumstances including course of dealing or usage of trade or course of performance." U.C.C. § 1-201(3) (2000).

85. FUJIMIYA, supra note 44, at 23.

86. See supra notes 16, 33 and accompanying text.
TRUST BETWEEN BUSINESS ENTITIES

Trust is a human emotion that an organization cannot experience literally. Members of one group, however, can form a consensus that members of another group are trustworthy and should be treated so as to preserve mutual trust. [[A] company may develop a character of sorts, in the form of those norms and expectations of its personnel that we call 'corporate culture.'...[C]orporate culture is a commitment mechanism aimed at building a certain reputation...]. Parties to a transaction can build confidence by, for example, exchanging "hostages," like key personnel. Such measures give a party confidence that the other will not torpedo the enterprise because it would incur serious costs if it did so.

Corporate offices often change hands, though. A new officer may not know of the relationship of trust with a partner. Even if she does know, a new officer may not feel bound by the informal commitments and understandings of her predecessors. If problems arise within the alliance, she may refuse to make concessions reciprocating the other's past concessions because the latter benefitted the predecessor's career, not her own; and she may lack the personal camaraderie with the partner's officers that would reassure her that concessions by her will be reciprocated. Even if a side has given hostages, scuttling the alliance may be cheaper than maintaining it.

Cooperation between partners can also be disrupted by the pursuit of sub-goals that is common among members of organizations. High officers on both sides may feel a sincere commitment to the alliance, but they cannot always make their subordinates cooperate, even if cooperation benefits the firm. For example, a firm's research and development director could withhold her best people from a joint venture because it is better for her own career to keep them herself. Risk-averse managers may also prefer firm growth to maximization of firm value.

When cooperation falters, partners dust off and read their contract, but they may have been careless, even deliberately so, in its drafting. Predicting how a court will fill the contract's gaps and construe fiduciary duties then becomes crucial in determining how the parties resolve their dispute. If courts demand high standards of fairness, sheer self-interest will deter each party from opportunism that could provoke judicial wrath. This prospect will bolster officers on each side who favor cooperation over opportunism. But if courts merely enforce

87. See BADARACCO, supra note 16, at 141-42 (stating that the fundamental links in alliances are between groups of people, not between organizations).
88. See id. at 141 (stating that a successful alliances needs "'champions'... on both sides—that is, managers with appropriate skills who are personally committed to making the venture work").
91. See HARRIGAN, supra note 13, at 364 ("The managers that built joint ventures did not continue to run them as their careers progressed.").
93. See Borys & Jemison, supra note 90, at 238.
the letter of the contract, one party may withhold cooperation, even though so doing violates the unwritten understandings of those on both sides who struck the agreement but declined to specify their understanding fully in writing.

THE GENERAL THEORY OF GAP FILLERS AND FIDUCIARY DUTIES

Robert Scott says, "the central task for the law of commercial contracts is to fill gaps in incomplete contracts." 94 Douglas Baird adds, "the principal measure of the success of our contract law is whether it in fact induces cooperation." 95 These claims seem surprising. Especially in contracts between merchants, why should the law not simply enforce the express terms and let the parties worry about any gaps therein? And why should the law seek to "induce cooperation" rather than letting market forces determine the proper level of cooperation? To advance the law of strategic alliances we need to understand not only whether Scott and Baird are right, but if so, why they are right.

Some evidence suggests that the law of fiduciary duties and gap fillers does matter. John Coffee finds: "A paradigm shift is now underway in the manner in which financial economics views corporate governance, with the new scholarship emphasizing both the centrality of legal protections for minority shareholders and the possibility that regulation can outperform private contracting." 96 Coffee focuses on public securities markets and legal protection of investors in public companies, but some of his analysis bears on strategic alliances. He notes the inevitable gaps in financial contracts and suggests the superiority of common law systems of corporate governance because "the common law encourages gap-filling, while the civil law tends to impede it. . . . The most important example for corporate law is the concept of fiduciary duty." 97 Of course, market economies allow people broad freedom to pursue their self-interest. Making fiduciary duties too high could unduly restrict that pursuit. The goal then, is to strike the optimal balance between self-interest and the altruism demanded by fiduciary duties.

The purpose of fiduciary duties is not to redistribute wealth from the rich and strong to the weak and poor. As Coffee shows, although people think business law leaves them vulnerable, they do not protect themselves with contractual safeguards; that would be too expensive. 98 Rather they avoid harm by refusing to make equity investments. Accordingly, legal protection of business participants benefits not only them but business enterprises themselves, which are thereby enabled to raise equity capital that is not available in legal systems that deny such protection.

95. Baird, supra note 92, at 584.
96. Coffee, supra note 4, at 2; see also Henry Hansmann & Reinier Kraakman, The End of History for Corporate Law 10 (Jan. 2000) (unpublished manuscript, on file with The Business Lawyer, University of Maryland School of Law) (finding the emergence in corporate law of an international "standard model" which includes as a "central tenet" that "minority or noncontrolling shareholders should receive strong protection from exploitation at the hands of controlling shareholders"). This model applies to close as well as public corporations. Id. at 11.
98. See id. at 2-3.
Gap Fillers and Fiduciary Duties in Strategic Alliances

The Difference Between Fiduciary Duties and Gap Fillers

Gap fillers and fiduciary duties are similar in many ways and the line between them is not bright. Both embody duties not drafted by the parties but imposed by law. Fiduciary duties may be seen as a subset of the broader category of gap fillers.99 Fiduciary duties differ, though, from gap fillers that are merely technical, such as the attendance necessary for a quorum. “A fiduciary is a person who undertakes to act in the interest of another person.”100 Fiduciary concepts evolved in English ecclesiastical and equity courts which applied religious and moral norms, and fiduciary doctrines still use moral concepts rarely employed for other gap fillers.102 Many commentators, however, now eschew moral analysis of fiduciary law and view “the conflict of interest problem affecting fiduciaries [as] one of maximizing the efficiency gains from specialization and minimizing the transaction costs associated with defining and enforcing the duties of fiduciaries while limiting any resulting cheating by fiduciaries to an acceptable level.”103

Breach of fiduciary duty often involves deception, so it is less likely to be detected than breaches of other duties.104 For this reason courts treat breach of fiduciary duty more severely than mere breach of contract.105 Fiduciaries are often better informed and more sophisticated than their beneficiaries, so contractual alteration of default rules is policed more closely by courts for fiduciary duties than for other gap fillers.106 Even here, though, the distinction between fiduciary duties and other gap fillers is not sharp. In both cases courts tailor remedies to the facts of the case. As for waivers, under the Revised Uniform Partnership Act waivers of the fiduciary duty of loyalty are permitted “if not manifestly unreasonable;”107 while contract terms are permitted to override the gap fillers of the Uni-


102. In Cardozo's famous words, the standard for fiduciaries is “[n]ot honesty alone, but the punctilio of an honor the most sensitive.” Meinhard v. Salmon, 164 N.E. 545, 546 (N.Y. 1928).

103. Alison Grey Anderson, Conflicts of Interest: Efficiency, Fairness and Corporate Structure, 25 UCLA L. Rev. 738, 758 (1978); see also Frank H. Easterbrook & Daniel R. Fischel, Contract and Fiduciary Duty, 36 J.L. & Econ. 425, 427 (1993) (“Acting on moral belief that agents ought to be selfless will not make principals better off; it will instead lead to fewer agents, or higher costs of hiring agents.”).


105. See Frankel, supra note 101, at 827-29.

106. For example, Delaware General Corporation Law section 144 seems to permit a self-interested transaction between a corporation and its officers or directors without regard to fairness if the transaction is approved by disinterested directors. See Del. Code Ann. tit. 8, § 144(a)(1) (1991). Delaware courts, however, reject the plain meaning of section 144 and hold instead that “[c]ompliance with section 144 merely shifts the burden to the plaintiffs to demonstrate that the transaction was unfair.” Cooke v. Oolie, No. CIV.A.11134, 1997 WL 367034, at *9 (Del. Ch. June 23, 1997), reprinted in 23 Del. J. Corp. L. 775, 796 (1998).

form Commercial Code if the contract terms are not "unconscionable." If there is a difference between these two standards, it is slight.

Courts and commentators widely agree that one function of contract law, especially in relational contracts and business associations, is to protect the "reasonable expectations" of the parties. In so doing, courts enhance trust. "Fiduciary law provides far stronger incentives for people to enter relationships in which they are exposed to risks from the other parties."

Should courts fill gaps only when both parties intended a term but neglected to write it out, or should they impose duties which the obligor never intended to assume? The distinction has little practical significance. Especially among business people "[i]ntention not otherwise revealed may be presumed to hold in contemplation the reasonable and [the] probable." Absent strong contrary evidence, it is reasonable and probable that the parties intended to maximize their wealth under the contract. Applying this principle also benefits society generally. Accordingly, gap fillers and fiduciary duties may be discussed together, although it is occasionally desirable to specify under which rubric a judicially-supplied legal obligation is to be placed.

Robert Hillman believes that for several reasons "fiduciary duties are largely ineffective in controlling opportunistic behavior by business partners." In particular, the indeterminacy of fiduciary duties and the costs of litigation (including damage to the business relationship) discourage suits over fiduciary duties. Nonetheless, Hillman believes most business people observe an ethic broader than mere fear of legal penalties and that judge-made fiduciary duties significantly influence this ethic. He quotes Edward Rock saying that in corporate law judges function "more as preachers than as policemen." Hillman and Rock follow a growing trend to focus on the aspirational or expressive function of law in shaping social norms.

Some scholars believe the law's preaching and policing functions are mutually exclusive. It seems more likely, though, that they are mutually supportive: "The

112. See Scott, supra note 94, at 602.
114. Id. at 72-73.
115. Id. at 73 n.63, (quoting Edward B. Rock, Saints and Sinners: How Does Delaware Corporate Law Work?, 44 UCLA L. Rev. 1009, 1016 (1997)).
117. Larry E. Ribstein, Law v. Trust, 81 B.U. L. Rev. 553 (2001); cf. infra notes 207-08 and accompanying text (enforcement of high fiduciary standards may encourage litigation which may undermine trust by conveying an impression that cheating is common).
trustworthiness of a party may be supported by direct assurances provided by third parties such as the government, [or] courts of law . . . ."  

COMPETING THEORIES OF GAP FILLERS

One approach to gap-filling is hypothetical bargain (or implicit contract) analysis, which involves "asking what contractual terms rational parties would have agreed to had they addressed ex ante the matter that falls into a contractual gap. For corporate contracts, the prevailing view is that this gap-filling principle should be 'maximize shareholder value.'"  

In non-corporate transactions this translates as maximize the wealth of the contracting parties.  

Courts maximize wealth by choosing gap-fillers that most parties want. This reduces the costs of contracting because parties need not draft a term if they accept the law's default rule. Transaction costs are further reduced by favoring "default rules that are more expensive to write ex ante." These include default rules requiring cooperation and good faith because it is harder to draft such requirements than to contract out of them. Business transactions generate positive externalities, including technological progress, increased employment and tax receipts, and enhanced competitiveness of American industry. Thus, by fashioning default rules that facilitate contracting, courts benefit not only contracting parties but society as a whole.

One problem with this approach is that not everyone wants default rules that maximize total wealth. Although most people are risk-averse, public investors can diversify their investments so that the performance of any single investment is insignificant. Thus, investors can be risk-neutral about each investment. Investors in non-public firms and those who invest their careers (or human capital) in an enterprise, however, cannot diversify away their risk. These types of investors include many owners of non-public firms in strategic alliances.

To accommodate these investors, courts can fashion default rules "tailored" to the facts of each particular case. Moreover, because the facts surrounding a relational transaction change over time, the default rules for that transaction could also change over time. For example, as trust and cooperation between the parties

118. Ben-Ner & Putterman, supra note 89, at 528.
119. Smith, supra note 99, at 217 (footnote omitted).
120. See id.
123. See BURTON G. MALKIEL, A RANDOM WALK DOWN WALL STREET 235-40 (5th ed. 1990) (stating that investors are risk-averse).
124. See id. at 235 ("diversification is a sensible strategy for individuals who like to reduce their risks").
125. See Henry Hansmann, Ownership of the Firm, 4 J.L. ECON. & ORG. 267, 294 (1988) ("Workers generally cannot diversify their source of income by working for more than one firm at a time . . . .").
126. See id.; Ayres & Gertner, supra note 121 at 91. This is often done under the rubric "rational expectations of the parties."
grow, the degree of loyalty and cooperation required by courts as a matter of fiduciary duties would also increase. Hypothetical bargain analysis is particularly complex during the performance phase, though, because the parties' relative bargaining strengths may shift as a result, for example, of sunk costs on one side. A hypothetical bargain would presumably forbid either party to take advantage of sunk costs when renegotiating a contract in order to prevent value-decreasing opportunism. Thus, courts must decide how the parties would have renegotiated their alliance pursuant to a hypothetical initial contract that forbids opportunistic renegotiation.

If maximizing the value of their project were the sole objective of strategic allies, courts would properly impose default rules requiring the highest degree of loyalty and cooperation. Such rules would forbid, for example, termination of an alliance effected solely to acquire the assets of the alliance for less than fair value. If, however, a party terminates because it has a more profitable alternative opportunity with a different partner, it is not clear that default rules should forbid the termination. Risk-neutral parties would not forbid termination if the total value of the alternative opportunity exceeded the total value of the existing undertaking. A party that is risk-averse, however, would demand compensation for any loss it suffers from termination by the other party. Constructing such a complex hypothetical bargain is a daunting judicial task.

Accordingly, implicit contract analysis "is frequently indeterminate and therefore manipulable." This is especially true if courts ask not what most risk-neutral parties would have agreed to, but what the specific parties (who may be risk-averse) would have agreed to or rationally expected. The problem is even greater if the default rules are not precise (or "crystal"), but are vague (or "muddy") standards—like "good faith" or "reasonable." Precise rules are easier for courts and parties to apply, but precise rules lack the flexibility of vaguer standards, which can be molded to the context of the individual case.

It is also claimed that "[b]asing legal rights on expectations is circular; the right must be specified first." This is an exaggeration; people often expect certain behavior of others without believing they have a right to that behavior. Still the claim has an element of truth; to some extent people expect others to grant them what the law requires but not more.

127. See supra notes 74-78 and accompanying text.
128. See infra notes 247-50 and accompanying text (discussing the effect of sunk costs on contracting).
129. See, e.g., Page v. Page, 359 P.2d 41, 45 (Cal. 1961) (holding that if a partner dissolved "in bad faith . . . by attempting to appropriate to his own use the new prosperity of the partnership without adequate compensation to his co-partner, the dissolution would be wrongful").
130. See supra note 104, at 68.
131. See supra note 122, at 1404-05 (discussing "crystal" and "muddy" default rules).
132. See supra note 122, at 1404-05 (discussing "crystal" and "muddy" default rules).
133. See supra note 122, at 1404-05 (discussing "crystal" and "muddy" default rules).
134. See supra note 104, at 78.
135. See supra notes 74-78 and accompanying text.
Costly litigation is more likely if parties cannot tell what default rules a court will impose. Therefore, "[t]he conventional assumption . . . is that in . . . commercial environments it is more important for the law to be certain than to be right." 136 Vague default rules disadvantage poorer and more risk-averse parties by encouraging litigation. 137 Scott advocates "[m]ajoritarian default rules . . . [because they] expand contractors' choices by providing widely suitable preformulations, thus eliminating the cost (and the error) of negotiating every detail of the proposed agreement." 138 This makes sense so long as preferring majoritarian default rules does not come at the expense of predictability.

A competing theory of gap-fillers posits that a contracting party may deliberately withhold information that would reduce its own return even if disclosure would increase the total joint value of the contract. 139 For this reason the law should sometimes impose "penalty" (or "information-forcing") defaults that "give at least one party to the contract an incentive to contract around the default rule . . . in order to encourage the parties to reveal information to each other or to third parties (especially the courts)." 140 Penalty defaults aid not only less-informed parties but also the courts. Ayres and Gertner opine:

If it is costly for the courts to determine what the parties would have wanted, it may be efficient to choose a default rule that induces the parties to contract explicitly. In other words, penalty defaults are appropriate when it is cheaper for the parties to negotiate a term ex ante than for the courts to estimate ex post what the parties would have wanted. Courts, which are publicly subsidized, should give parties incentives to negotiate ex ante by penalizing them for inefficient gaps. 141

Doing this would discourage recourse to the courts, which is costly to taxpayers. The better-informed party is also likely to be a repeat player—that is, one that enters into many similar transactions. Drafting contracts is cheaper for repeat players because the costs are spread over many contracts. Further, by penalizing a party who withholds information, penalty defaults enhance trust, which is crucial to strategic alliances.

This approach poses some problems, though. Especially in strategic alliances, many of which involve provision of technology by small firms, the larger party is not always better informed; each party may be better informed on certain issues. It is not even clear what "better informed" means. For example, should a court consider the sophistication of the parties' lawyers in determining which party is better informed? Uncertainty about which party a court will penalize would in-

136. Scott, supra note 94, at 598.
139. See Ayres & Gertner, supra note 121, at 94.
140. Id. at 91; see also Scott, supra note 94, at 609 (using the term "information-forcing defaults").
141. Ayres & Gertner, supra note 121, at 93.
crease litigation. It could also be perverse to penalize a party for being better informed. In effect, penalty defaults reward parties for remaining ignorant and encourage them to pretend ignorance.142

Moreover, penalizing a party for failure to draft explicit contract terms thwarts the purpose of default rules to reduce the costs of contracting by providing parties a least-cost, off-the-rack set of contract terms.143 True, Ayres and Gertner would use penalty defaults only "when it is cheaper for the parties to negotiate a term ex ante than for the courts to estimate ex post what the parties would have wanted."144 Uncertainty about which those situations are, however, will increase litigation. Uncertainty would be especially frequent in contracts involving vague duties of performance (like "best efforts") and close cooperation over long periods of time; i.e., especially in strategic alliances.

Finally, default rules are part of the status quo, which contracting parties tend to prefer. Therefore, choosing penalty default rules rather than the most efficient default rules may lead contracting parties to choose the less efficient rule.145 Accordingly, courts should employ penalty defaults sparingly.

**INCOMPLETENESS IN STRATEGIC ALLIANCE CONTRACTS**

**INCOMPLETENESS IN BUSINESS CONTRACTS**

A naif might assume that business people spell out all their contract duties. Not so. The volume of intercorporate litigation alone shows the incompleteness of business contracts, since serious disputes do not arise if contracts are fully specified.146 Still, it is striking how incomplete business contracts often are: "many, if not most, ... reflect no planning, or only a minimal amount of it, especially concerning legal sanctions and the effect of defective performances."147 There are exceptions: "Exchanges are carefully planned when it is thought that planning and a potential legal sanction will have more advantages than disadvantages."148 A factor favoring specificity is "complexity of the agreed performance over a long period [of time]. Another factor is whether or not the degree of injury in case

142. See Gillette, supra note 75, at 576-81 (1990) (arguing against rewarding willful or negligent ignorance).
143. See supra notes 121-22 and accompanying text.
144. See Ayres & Gertner, supra note 121, at 93.
145. See Korobkin, supra note 135, at 668.
146. One study found that intercorporate litigation in the auto industry actually grew from the early 1970s until the late 1980s. See generally Lane Kenworth et al., "The More Things Change...": Business Litigation and Governance in the American Automobile Industry, 21 LAW & SOC. INQUIRY 631 (1996). Moreover, although it found that litigation seems to have declined since then, the reason for the decline is greater resort to alternative dispute resolution, not a reduction of disagreements resulting from greater contract specificity. Id. at 675-76.
147. Macaulay, supra note 76, at 60; see Holmström & Roberts, supra note 17, at 81 ("[C]ontracts between the Japanese automakers and their suppliers are short and remarkably imprecise, essentially committing the parties only to work together to resolve difficulties as they emerge. Indeed, they do not even specify prices, which instead are renegotiated on a regular basis.").
148. Macaulay, supra note 76, at 65.
of default is thought to be potentially great."149 These factors are common to strategic alliances.

**Why are Contracts Incomplete?**

Even if complete contracts are possible in theory, parties do not even try to create them: "[a]ll contracts have gaps."150 The main reason for gaps is that negotiating and drafting contracts is expensive. If a contingency is unlikely to occur or to be very important if it does occur, the cost of drafting a term to cover that contingency may exceed the benefits of adding the term.151 This problem is especially severe for strategic alliances. Due to the length and complexity of the contemplated relationship, the contingencies are much more numerous than in, for example, a one-shot sale of goods.152

The cost of drafting a precise term may be warranted if it will be used in many transactions.153 Even if the parties are not repeat players, their lawyers may be. In corporate acquisitions, for example, "the general contents of the agreement have by now become pretty much standardized."154 This occurred because lawyers who specialize in acquisitions developed standard terms. The drafting of strategic alliance contracts is less concentrated in a group of specialists, though, and alliances

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149. *Id.* Macaulay studied sales contracts in which "there . . . [was] little room for . . . difference of opinion about the nature and quality of a seller's performance." *Id.* at 62. There is even less room for dispute about a buyer's obligations. In strategic alliances, though, the duties of both partners are usually more complex and, therefore, more subject to dispute. Further, in the transactions Macaulay studied "[w]hen defaults occur[red] they [were] not likely to be disastrous because of techniques of risk avoidance or risk spreading." *Id.* at 63. These included maintaining relations with several suppliers or customers so that if one of them caused trouble, the victim could switch to another. *Id.* The very threat of switching encourages cooperation and deters opportunism. In strategic alliances, though, it is usually impossible to keep a reserve of alternative partners in case one's current partner misbehaves.


153. "If conduct will be frequent, the additional costs of designing rules—which are borne once—are likely to be exeeded by the savings realized each time the rule is applied." Louis Kaplow, *Rules Versus Standards: An Economic Analysis*, 42 Duke L.J. 557, 621 (1992). If certain transactions are common in an industry, an industry trade group may promulgate standard terms that parties to these transactions can adopt. See generally Lisa Bernstein, *Merchant Law in a Merchant Court: Rethinking the Code's Search for Immanent Business Norms*, 144 U. Pa. L. Rev. 1765 (1996). Such conditions do not exist for most strategic alliances.

are more varied and changing more rapidly than are acquisitions, so the evolution of standard terms is more primitive.\textsuperscript{155}

Strategic alliances are not repeat transactions—at least not for both parties. A company with many franchises can spread the costs of drafting a detailed standard franchise contract across many agreements. It can also claim it needs uniform agreements in order to resist requests by a franchisee for different terms. There are fewer gaps for courts to fill in such cases. Because of the franchisor's greater knowledge and sophistication, however, judicially created fiduciary principles may often be needed in such cases to prevent unfairness.

The use of fiduciary duties is not a zero-sum game in which one party's gain equals the other's loss. For example, a franchisor will want to attract the best franchisees by promising to treat them fairly. If potential franchisees are unsophisticated, though, they may be unable to distinguish "fair" from "unfair" franchisors. Robust fiduciary standards then, not only protect franchisees, but also benefit "fair" franchisors by enhancing their trustworthiness among potential franchisees.\textsuperscript{156}

Further, in strategic alliances performances are unusually hard to define, monitor, and measure.\textsuperscript{157} Indeed, this is a major reason for creating alliances. Suppose, for example, one party agrees to improve a product or to create a new one for a price. If the contract defines a standard to be achieved and sets it too low, the party has no incentive to exceed the standard, even if the value of a better product might exceed its development costs. If the standard is set too high, the party will reject the contract. Therefore, the best contract solution may be to require the party to use its "best efforts." Such terms (including "reasonable" and "good faith") are often used to define duties in strategic alliances.\textsuperscript{158} These terms are so vague, though, that the parties may omit them because they do not sound "legal."

Parties may leave contracts incomplete to preserve flexibility.\textsuperscript{159} That is, if a contingency is hard to anticipate and deal with in advance, the parties may leave it to be resolved later.\textsuperscript{160} In particular, they may not initially know what to expect of each other.\textsuperscript{161} Further, in long-term contracts parties often tacitly agree to amend their bargain if unexpected conditions arise.\textsuperscript{162} Although this behavior is understandable, leaving issues open and relying on future adjustments invite misunderstandings and opportunism. The parties may honestly disagree when they

155. See Glover, supra note 1, at 9 (referring to a lack of standard-form contracts for joint ventures).
156. See generally supra notes 72-86 and accompanying text (discussing significance of trust in strategic alliances).
157. See Klein & Murphy, supra note 37, at 267-68 (stating that a fully specified contract may be impractical because "performance may be prohibitively costly to measure and to specify in a way that contractual breach and the extent of damages can be proven to the satisfaction of the court").
158. See GUTIERMAN, supra note 5, at 117.032 (sample provision that each party "agrees to cooperate fully with the other"); see also Charles J. Goetz & Robert E. Scott, Principles of Relational Contracts, 67 VA. L. REV. 1089, 1111-30 (1981).
159. See Gifford, supra note 150, at 469.
160. See LORANGE & ROOS, supra note 28, at 268-69.
162. See Palay, supra note 28, at 279-85 (noting that in the rail freight industry parties were expected to be, and generally were, open to adjustments of contract terms).
later (re)negotiate, or one party may use a strategic advantage at that time to demand unfair terms. Similarly, parties may leave contracts incomplete because they rely on termination of the contract to escape from an unacceptable situation.\textsuperscript{163} Fear of termination may then encourage both parties to be reasonable. Indeed parties sometimes eschew formal contracts to make the weapon of termination easier to use.\textsuperscript{164} But this, can also backfire—a party may use termination as an offensive rather than a defensive weapon.\textsuperscript{165}

Contracting for alliances is further complicated by the need to specify governance mechanisms. Economists often classify contracts as involving markets or hierarchies.\textsuperscript{166} Parties to market transactions remain independent except for the duties that the contract stipulates. Some tasks are too complex to be spelled out in advance. For example, an employer cannot fully specify the employee's duties in advance but needs discretion to direct the employee as need arises. In such cases the parties agree to a hierarchy: one party (e.g., the employee) submits to the control of the other (e.g., the employer).

Alliances are not market transactions because the parties' duties are not fully specified. Neither are they hierarchies, because control is usually shared rather than assigned to one party. Shared control complicates drafting. One study found: "It was often necessary to spell out responsibilities carefully and to keep the lines of authority clear in order for a joint venture to succeed. Otherwise, squabbles ensued."\textsuperscript{167} If one party gets general control, the other may demand a veto in certain circumstances, which then must be defined.\textsuperscript{168} The junior partner may also (or instead) obtain a buyout provision so it can exit if it feels the senior partner is being unfair.\textsuperscript{169} If parties will share control equally, then they will probably want a deadlock breaking device such as a neutral director unaffiliated with either party and acceptable to both, or an arbitration clause.\textsuperscript{170}

\begin{footnotesize}
\begin{enumerate}
\item[163.] See Johnston & Lawrence, supra note 71, at 100-01.
\item[164.] "[A] number of alliances do not use a contract in the traditional sense of the word." Tim Underhill, Strategic Alliances: Managing the Supply Chain 98 (1996). A letter of intent may be used instead of or in addition to a formal contract. See also id. at 99; Bernstein, supra note 151, at 227-29 (the costs of enforcing a contract may be so high that the parties prefer to forego a formal contract).
\item[165.] See Hamel et al., supra note 23, at 137.
\item[166.] This is indicated by the very title of Oliver E. Williamson's Markets and Hierarchies.
\item[167.] Harrigan, supra note 13, at 369.
\item[168.] See Zenichi Shishido, Conflicts of Interest and Fiduciary Duties in the Operation of a Joint Venture, 39 Hastings L.J. 63, 70 (1987) (minority partner in joint venture usually has some veto).
\item[169.] See infra notes 270-73 and accompanying text (describing buyout provisions).
\item[170.] Neutral directors are common in venture capital investments. See Steven Kaplan & Per Stromberg, Financial Contracting Theory Meets the Real World: An Empirical Analysis of Venture Capital Contracts 17 (Mar. 2000) available at http://papers.ssrn.com/paperid=218175 (unpublished manuscript) (in venture capital investments surveyed outsiders held over twenty percent of board seats and neither investors nor founders held a majority in sixty-two percent). Although venture capital investments are not strategic alliances, the two have several similarities. The example of venture capital shows the eagerness of parties to relational contracts to have a private third party to resolve differences rather than giving one party control or suffering deadlocks.
\end{enumerate}
\end{footnotesize}
Another complication in many strategic alliances is the need to cover future financing. For example, if a joint venture develops a valuable product, it may then need more money to manufacture and market the product. In drafting the initial contract, the parties may anticipate that one or both of them will be unable to provide its share of future financing. In such cases the parties need provisions for raising future capital. Such terms are rarely needed in other kinds of contracts.

Negotiations are further tangled for the many alliances among more than two parties. "[R]unning a triparty joint venture was extremely difficult, especially with respect to . . . direction and control." As the number of parties increases, the number of pairs of parties that must reach agreement grows geometrically, not arithmetically, making contracting more difficult.

**Incomplete Contracts and the Role of Trust**

In strategic alliances success depends heavily on trust and cooperation. "Businessmen often prefer to rely on 'a man's word . . . .""

Trust often grows. As it does, "mechanisms of social control, as opposed to formal contract . . . become increasingly important as the relationships between firms develop over time." Because duties in alliances can be defined only vaguely, the level of a party's cooperation depends largely on how much it trusts the other. Hard bargaining erodes trust, though, by signalling others that one will do no more than is expressly required: "parties propose simple contracts . . . in order to signal that they are trustworthy." As Macaulay found, "[s]ome businessmen object that in . . . a carefully worked out relationship, one gets performance only to the letter of the

171. Harrigan, supra note 13, at 368; see also Gulati, supra note 5, at 96 ("[M]ultilateral alliances pose larger organizational problems.").

172. Macaulay, supra note 76, at 58.

173. Lorance & Roos, supra note 28, at 19; see also Fukuyama, supra note 44, at 340-42 (mentioning strategic alliances as depending on trust).

174. See Lorance & Roos, supra note 28, at 79.

175. Gulati, supra note 5, at 94. Thus, when two parties enter repeated alliances, in later transactions they often "don't bother to write detailed contracts." Id. at 95 (quoting one firm manager).

176. See supra notes 152-58 and accompanying text.

177. See infra notes 189-91 and accompanying text (discussing the relevance of trust in strategic alliances).

178. Eggleston et al., supra note 24 (manuscript at 22); see Jordan D. Lewis, Trusted Partners: How Companies Build Mutual Trust and Win Together 263-64 (1999) (joint ventures involving large companies often use simple, incomplete contracts); see also Lisa Bernstein, The Silicon Valley Lawyer as Transaction Cost Engineer?, 74 OR. L. REV. 239, 249-50 (1995) (stating that hard bargaining may hinder good relations between joint venture partners); David Charny, Nonlegal Sanctions in Commercial Relationships, 104 HARV. L. REV. 373, 405 (1990) (same).
contract. . . whereas performing to the spirit of the contract would offer mutual expected gains." 179 Literal compliance with a contract may violate the other party's reasonable expectations. 180 This phenomenon is not limited to business dealings: "People who distrust the motives of others tend to have more rigid and narrow expectations and to provoke the very reactions they fear." 181 It is no surprise, then, one study found that many business "managers found the act of writing contracts unpleasant." 182

This attitude affects the decisions of business people about when and how lawyers should enter negotiations. One study found:

The most frequent answer explaining why announced joint ventures never went beyond the discussion stage was that ventures were sunk by lawyers. This explanation suggests that managers were homogeneous in their outlooks; lawyers were too adversarial. A more likely explanation for joint-venture deaths at the contract-writing stage was that partners did not think through their arrangements adequately before they reached the altar. The probing questions the lawyers asked exposed these shortfalls in partners' agreements, and the venture fell apart. 183

Stewart Macaulay quotes one business lawyer, "businessmen when bargaining often talk only in pleasant generalities, think they have a contract, but fail to reach agreement on any of the hard, unpleasant questions until forced to do so by a lawyer." 184

If disputes arise, though, a party may rue having heavily relied on trust. "Many managers . . . suggested that the only time they consulted their contracts was when their joint ventures failed. (Then they hoped that their lawyers had written a good divorce settlement for them.)" 185 "One [lawyer] stated that he was 'sick of being told, "We can trust old Max," when the problem is not one of honesty but one of reaching an agreement that both sides understand." 186

Since they dislike lawyers, business people often exclude them from initial negotiations, agree on main terms between themselves, and bring in their lawyers

179. Macaulay, supra note 76, at 64; see also Samuel Bowles, Endogenous Preferences: The Cultural Consequences of Markets and Other Economic Institutions, 36 J. ECON. LIT. 75, 95 (1998) (cooperation is more likely if parties consider a contract incomplete).


181. John G. Holmes & John K. Rempel, Trust in Close Relationships, in CLOSE RELATIONSHIPS 187, 190 (Clyde Hendrick ed., 1989); see also GOVIER, supra note 64, at 38 (trust and mistrust perpetuate and feed on themselves).

182. HARRIGAN, supra note 13, at 363.

183. Id.; see also David Ernst & Steven L. Glover, Strategic Alliances, INSIGHTS (Aspen Law & Bus.), Oct. 1997, at 6 (in negotiating strategic alliances, the instincts of lawyers to minimize risk clashed with the instincts of business people to take risk); Glover, supra note 1, at 3 (lawyers' inclinations may clash with the desire of partners "to establish a long-term cooperative relationship").

184. Macaulay, supra note 76, at 59.

185. HARRIGAN, supra note 13, at 363; see also Johnston & Lawrence, supra note 71, at 101 (to have a successful alliance parties "must be able to punish partners for acts of opportunism and gaming").

only at the last possible moment to put the agreement in "legal language." Whatever the wisdom of this practice, it helps explain the incompleteness of business contracts. The business people on one or both sides may not realize the gaps or possibilities for opportunism in their agreed terms until the lawyers appear late in the negotiating game. At that point the business people may fear that they would look foolish and unreasonable if they tried to renegotiate points already agreed upon. Instead they must hope that a court will fill the gaps and deploy fiduciary duties to curb opportunism.

Reliance on trust poses further risks in strategic alliances. First, they are major transactions; problems can be more costly than in the typical sale of goods. Second, they are not repeat transactions. "The mere anticipation of mutually rewarding future transactions maintains the cooperative equilibrium" in on-going supply relationships. Third, trust and cooperation are less important where there is "a thick market for substitute performance." Well-developed markets eliminate much of the need for legally mandated mutual cooperation because parties trading in these markets can often make optimal adjustments unilaterally by, for example, purchasing the necessary adaptation from the lowest bidder on the open market. But, "as specialization increases, each party becomes more vulnerable to strategic demands by the other." This vulnerability and the corresponding need for trust is high in most strategic alliances.

One factor in trust is reputation. Business people seek partners with good reputations because they usually have good character and behave fairly so as to maintain their reputations. This reliance reduces what can be considerable search costs of finding a trustworthy partner. It also obviates detailed contracts: "trust and nonlegal sanctions encourage the formation of simple contracts." Reliance on reputation, however, can backfire. It does not preclude litigation. Third parties usually cannot tell who is lying or misbehaving in a business dispute,

187. See Kenneth R. Margolis, The COSE Study: A Report on Small Business Client Satisfaction with the Delivery of Legal Services 20 (1993) (unpublished manuscript, on file with The Business Lawyer, University of Maryland School of Law) (nearly eighty percent of business people surveyed brought their lawyers into business transactions only after most details were settled, or when it was absolutely necessary to do so, or never).

188. They could also incur legal liability if they already had sufficient agreement to create a contract or if their statements had led the other party to incur costs in reliance thereon, thereby giving rise to pre-contractual liability. See E. Allen Farnsworth, Precontractual Liability and Preliminary Agreements: Fair Dealing and Failed Negotiations, 87 COLUM. L. REV. 217 (1987).

189. Robert E. Scott, Conflict and Cooperation in Long-Term Contracts, 75 CAL. L. REV. 2005, 2048 (1987); see also Holmstrom & Roberts, supra note 17, at 81 (between Japanese automakers and suppliers short, imprecise contracts were adequate because of "the long-term, repeated nature of the interaction").

190. Scott, supra note 94, at 612; see also Macaulay, supra note 76, at 58, 63, 66 (contracting is short when substitutes are available).

191. Scott, supra note 94, at 612.

192. See Charyn, supra note 178, at 393-95.

193. See Gulati, supra note 5, at 107 ("Firms ... can significantly reduce their search for a new partner when they decide to ally with an entity they already trust ... ").

194. Eggleston et al., supra note 24 (manuscript at 23); see also Antony W Dnes, A Case-Study Analysis of Franchise Contracts, 22 J. LEGAL STUD. 367, 373, 377-80 (1993) (franchisors have a contractual right to abscond with "hostages" but rarely do so because of their concern for their reputations).

195. See Gillette, supra note 75, at 537 (indicating that parties with a good reputation sometimes behave unfairly).
so they may blame both parties equally. To preserve its reputation, then, an innocent party may feel as much pressure as the guilty party to end the dispute by making concessions; or even more pressure if reputation is more important to the innocent than to the guilty party. In such cases a judicial decision can resolve not only the legal dispute but also the reputational issue by declaring which party is innocent and which is guilty. This function is not unique to business disputes but is part of the general legitimizing function of adjudication.

To do this, however, courts must apply the same principles that business people weigh in determining reputation. If a court simply enforces the letter of the contract and disregards principles of fairness, its judgment may even mislead third parties by, for example, appearing to vindicate a party who has flouted the business community’s notions of fairness.

**Course of Dealing**

The course of dealing between parties may show how close a relationship they intend, and their intentions may change over time. Deciding how a course of dealing should affect fiduciary duties is often difficult, though, because ordinarily the parties say nothing explicitly about changing their legal duties. The parties may honestly disagree about the level of trust and cooperation that they intend at any particular time. Moreover, the very concept of intent is problematic for fictitious legal persons like business entities.

Courts should enforce reasonable expectations even if this imposes on a party greater obligations than it intended to assume. A party should be bound by reasonable expectations that its conduct has induced in the other party, even if the inducement was accidental, unintended. As between the two parties, the one whose understanding is more reasonable should prevail. Anyone who fears being bound by the other’s mistaken (but reasonable) misapprehension can protect itself by expressly informing the other of its intentions. By protecting reasonable expectations, courts foster trust and cooperation. The alternative of ignoring reasonable but unilateral expectations creates a trap for the trusting and unwary and forces prudent parties to demand repeated, detailed revision of the explicit contracts. That would be inefficient and detrimental to business and to society at large.

**Risk**

In general courts should act to maximize the joint wealth of the parties because that is probably what they want. This view assumes the parties are risk-neutral.\(^{196}\) Some firms are risk-averse, often because managers (like most people) are risk-averse even if their shareholders want the firm to be risk-neutral because they

\(^{196}\) See William M. Landes & Richard A. Posner, *The Positive Economic Theory of Tort Law*, 15 Ga. L. Rev. 851, 867 (1981) (defending the presumption of risk-neutrality). The presumption should be especially strong where the parties have agreed to cooperate, to use best efforts, or to act on good faith. Though vague, all these phrases connote each party’s willingness to strive for mutual benefit rather than to be narrowly selfish. See Gillette, supra note 75, at 540.
have diversified portfolios. 197 But other parties are risk-preferers. 198 Therefore, courts should assume risk-neutrality unless the parties have evinced a different intent. This is not only the statistically most reasonable assumption but also best for society because it maximizes total wealth.

Of course, parties may disagree about risk, even when both are risk-neutral, if they bear risks of an undertaking unequally. If, for example, one joint venturer contributes a patent while the other finances research to develop the patented device and they share profits equally, the latter will want higher potential profits to justify further research and development costs. It is proper for a court to weigh this in ascertaining the parties' reasonable expectations.

**MISUNDERSTANDINGS ABOUT COMPLETEENESS IN STRATEGIC ALLIANCE CONTRACTS**

Courts may mistakenly assume that strategic alliance contracts are complete. First, the allies are usually large firms and sophisticated—unlike, say, consumers, who may not understand unfair contracts. Second, strategic alliances are major transactions which might be expected to be carefully negotiated—unlike routine, minor transactions to which parties often give little thought. Third, strategic alliance contracts are usually long and complicated. For these reasons a court may presume that the contract is fair and complete so that the court need not fill alleged gaps or impose fiduciary duties.

That presumption is inappropriate. Even a company sophisticated in some field of business may lack experience with strategic alliances. Since there is not (or, at least, not yet) a specialized bar for strategic alliances, and because many parties to alliances are fledgling, cash-starved firms, their lawyers may also know little about alliances. 199 Thus, even contracts between merchants may have large gaps and unconscionable terms. 200

Because performances are hard to define and to monitor in a strategic alliance and one or both parties lack critical information, even a long, complex contract heavily negotiated between sophisticated parties will have major gaps. 201 Despite their sophistication—or rather because of it—parties will not spend more negotiating a contract term than the term would be worth. Moreover, as noted, hard bargaining can erode the mutual trust needed for a successful alliance. 202 Again,

197. See id. at 554-56 (opining that some firms are risk-averse).
198. See id. at 557-60.
199. Bernstein, supra note 178, at 252, says lawyers often educate unsophisticated entrepreneurs in venture capital financings. This is not always true, especially in smaller financings. Similarly, in strategic alliances, especially smaller ones, at least one side may lack sophisticated counsel because it wants to limit its expenses and because using sophisticated counsel may erode the trust and cooperation that the parties want to foster. Business people also tend to minimize the lawyers' role in negotiations, which limits the lawyers' ability to educate their clients and suggests that business people may not heed their lawyers much, anyway. See supra text accompanying note 185.
201. "Complexity in a contract is often an appropriate response to asymmetry of information and monitoring difficulties." Eggleston et al., supra note 24 (manuscript at 13).
202. See supra notes 178-79 and accompanying text.
"many, if not most, [business] exchanges reflect no planning, or only a minimal amount of it, especially concerning legal sanctions and the effect of defective performances." Accordingly, the parties may count on courts to demand fair conduct in ways that their agreement does not specify.

**GAP FILLERS AND FIDUCIARY DUTIES IN STRATEGIC ALLIANCES**

**EXTERNALITIES FROM ADJUDICATION**

Adjudication generates positive externalities. Business disputes are common but few of them wind up in court. The disputants bargain in the shadow of the law; they try to predict what a court will do if they resort to litigation. Reported court decisions promote settlements by giving them guidance, so it is important how courts handle gap fillers and fiduciary duties in strategic alliances. If courts choose bad default rules, contracting parties must either accept those bad rules or incur the cost of drafting around them.

Blair and Stout posit negative externalities from frequent fiduciary duty suits: suits cause "the increase in opportunistic behavior that results from suggesting that breach of duty is common, even normal, in business relationships." Blair and Stout advise courts to declare high fiduciary standards but not to enforce them through liability.

This is a crucial claim—and it seems gravely wrong. It suggests that the ideal level of litigation over fiduciary duties is zero because that would signal that no fiduciary ever violates its duties. More likely, though, it would breed cynicism as both fiduciaries and beneficiaries realized that fiduciary duties are empty prom-

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203. Macaulay, supra note 76, at 60.
204. See supra text following notes 188 and 195 and accompanying text.
205. Professor Ribstein proposes laws recognizing a new form of business organization—the "contractual entity"—in which "the parties have no duties to each other except as provided in their agreement." Ribstein, supra note 3, at 435, 437. Although this article advocates strong fiduciary duties, the two proposals are not necessarily inconsistent. First, Professor Ribstein's category of "contractual entity" excludes the many alliances that fall under another category of business associations. Most joint ventures, for example, are either incorporated or treated as partnerships. Second, Professor Ribstein's proposed default rule of no fiduciary duties applies only to an alliance that registers as a "contractual entity" and so voluntarily chooses this rule. Id. Third, Professor Ribstein would enforce duties the parties "provided in their agreement" as well as the "good faith duties of the sort that are implicit in contracts generally." Id. at 437. This leaves some room for gap-filling and imposing fiduciary duties.
206. See Jeffrey N. Gordon, The Mandatory Structure of Corporate Law, 89 COLUM. L. REV. 1549, 1565-66 (1989). Other factors also influence settlements, including calculations of whether the parties can sustain a long, expensive court battle and how litigation will affect their reputations.
207. Blair & Stout, supra note 26, at 73 (footnote omitted). They also argue that frequent suits discourage trust by signaling that a relationship is "competitive and untrusting, rather than cooperative and trusting" and that the two sides are not "members of a common ingroup." This would reduce willingness to look after the other party's interests. Id. at 73 n.173.
   taf?abstract_id = 240389 (unpublished manuscript) argues that "medium" enforcement of contracts is undesirable because it "crowds out" trust. The assumptions of their model and laboratory experiment, however, seem so removed from the reality of strategic alliances as to be irrelevant to them.
ises. 209 Judges would be viewed as hypocrites who say one thing but do another. Certainly it is not accepted in other areas of the law that suits to rectify wrongdoing actually encourage it by publicizing its existence. Legal systems that impose higher fiduciary duties get better behavior. 210 This claim by Blair and Stout even clashes with their own assertion that "trust is easier to destroy than to create." 211

Further, Blair and Stout implicitly deny the importance of reputation. Concern for one's reputation depends on the expectation that good or bad behavior will be publicized. To Blair and Stout though, publicity about misconduct backfires by precipitating more of it. This contradicts the axiom epitomized in Brandeis's adage, "[S]unlight is the best disinfectant; electric light the best policeman." 212 Accordingly, Blair and Stout's theory of a negative externality from fiduciary duty suits should be rejected.

SHOULD GAP FILLERS BE THE SAME FOR ALL FORMS OF STRATEGIC ALLIANCES?

The legal differences among the many forms of alliances are numerous and mostly esoteric. Often parties think little about the choice of form, so perhaps the law should assign default rules and fiduciary duties for alliances with close attention to the facts of the specific case but with little regard for the form of entity. Both case law and commentary offer support for this approach. Courts have edged away from the tradition that fiduciary duties are higher in partnerships than in corporations. The emerging view is that fiduciary duties should be higher in smaller entities—including both partnerships and close corporations—than in larger entities—mostly public corporations. 213

Courts have also labored to narrow the differences in the statutory default rules for various business entities. For example, a partnership (including a joint venture) at will can be dissolved without statutory penalty by any member at any time, but in most states a corporation can be dissolved only by a majority of the board, or shareholders, or both. 214 In partnership law, courts have invoked fidu-

209. Imposition of legal sanctions for some behavior inclines people to desist from and condemn that behavior; lack of sanctions has the contrary effect. See Dan M. Kahan, Trust, Collective Action, and Law, 81 B.U. L. Rev. 333, 345 (2001); see also supra notes 65-67 and accompanying text (stating that norms of trust and cooperation require the law's support).

210. See Rafael LaPorta et al., Investor Protection and Corporate Governance, 58 J. Fin. Econ. 3, 9 (2000) (common law systems, which impose higher fiduciary duties, lead to higher fiduciary conduct and greater willingness of investors to commit money to corporate fiduciaries).

211. Blair & Stout, supra note 26, at 47.

212. LOUIS D. BRANDEIS, OTHER PEOPLE'S MONEY 92 (1914).

213. See, e.g., Michaels v. Michaels, 767 F.2d 1185, 1196-97 (7th Cir. 1985) (using a standardized fiduciary duty but advocating case-by-case tailoring of standards); Toner v. Balt. Envelope Co., 498 A.2d 642, 650 (Md. 1985) (using a standardized fiduciary duty but advocating case-by-case tailoring standards); see also EASTERBROOK & FISCHER, supra note 99, at 244 (citing Michaels with approval and noting versatility of such an approach).

ciary duties to limit opportunistic dissolutions, while in corporations they have ordered dissolution to rescue oppressed minority shareholders.

Nonetheless, different entities should not be treated identically. The respect due to legislatures counsels against disregarding statutory differences. Also, though little thought is given to the choice of entity in some alliances, in others it receives much thought. Courts should take care not to frustrate rule choices intended by the parties. The question of how much weight to give the choice of entity when filling gaps is often difficult because gaps occur only when parties do not specify what they want. Courts can often infer the parties' intentions from the facts of a case, however. How precise and confident the inference is will vary from case to case. Sometimes, for example, there is abundant evidence of a desire for a high degree of trust and cooperation; in others there is a dearth of such evidence.

**HIGH OR LOW FIDUCIARY DUTIES?**

Before discussing specific issues, it is appropriate to ask whether fiduciary duties in strategic alliances should generally be high or low. Although fiduciary duties should not be so high as to make alliances unprofitable for either party and thereby discourage the creation of alliances, they should be high enough to deter behavior that increases one party's profit but imposes on the other an even greater loss so that the total value of the deal is reduced.

Eric Talley argues that high fiduciary duties induce excessive monitoring by parties seeking profit by finding breaches by the other party. This concern seems overblown, at least in the context of strategic alliances. Talley envisions individual parties who reduce their work for the entity in order to increase their monitoring of others. This is not true of alliances between firms, which can assign agents to monitor their partners without reducing their work for the alliance. Also, as Talley recognizes, considerations are different when a party is a repeat player concerned about its reputation. Many parties to alliances are (or hope to be) repeat players.

Others argue along similar lines that high fiduciary duties must be vague and therefore will encourage expensive, divisive litigation rather than “resolving problems cooperatively.” This is also dubious. By promoting trust and cooperation, high fiduciary duties encourage parties to work out disputes amicably and discourage strategic behavior that spawns disagreements.

215. See supra note 129.
216. See Franklin A. Gevurtz, Corporation Law § 5.1.2(c), at 471-75 (2000).
217. See Eric Talley, Taking the “I” out of “Team”: Intra-Firm Monitoring and the Content of Fiduciary Duties, 24 J. Corp. L. 1001, 1003, 1016, 1027 (1999). Talley refers to intra-firm monitoring, but his reasoning could also apply to extra-firm relationships of trust and confidence, including alliances. Moreover, many alliances (like joint ventures) are organized as firms.
218. Id. at 1003.
219. Id. at 1029.
Some argue that high fiduciary duties are unnecessary, at least in joint ventures, because joint venturers are sophisticated and value their reputations. Indeed, the parties may be more sophisticated than the court, which may be unable to ascertain when the parties have deliberately omitted a term or which implied term is most appropriate. Further, one alliance constitutes only part (often small) of the business of the parties, who often owe fiduciary duties to others in other transactions. Perhaps then, courts should apply lower fiduciary duties here than for, say, a law firm, to which the partners devote their full, undivided professional attention.

Although these are good reasons for courts to be cautious in crafting fiduciary duties for strategic alliances, other factors argue for high duties. As noted before, even sophisticated parties agree to incomplete contracts in strategic alliances. Thus, failure to specify a duty does not mean the parties decided against such a duty, especially if the parties were not equally sophisticated or informed when they contracted. Concern for one's reputation does not always deter opportunism, especially if the stakes are high and the miscreant expects to keep its misconduct hidden. By threatening exposure, courts deter misconduct and spur wrongdoers to settle before their reputations are tarnished by an adverse judicial pronouncement. Thus, high fiduciary duties do not interfere with but bolster reliance on reputation.

To Francis Fukuyama, the litigation explosion shows a decline of trust and also exacerbates it; that is, it is both a symptom and a cause. Some argue that court enforcement of social norms actually undermines those norms: "[A]ny effort to judicialize... social rules will destroy the very informality that makes... [extra-legal sanctions] so effective in the first instance." This seems wrong. Most commentators believe that when the law follows social norms, it bolsters those norms and thereby increases trust and social capital. Similarly, the law erodes social norms when it ignores them.

This is why people often fight over laws whose function is mostly symbolic. In 1954, for example, the Supreme Court outlawed de jure racial segregation of public schools. Today public schools are no more racially integrated than in 1954, but racial attitudes have changed considerably, and the law's condemnation of racial segregation and discrimination is generally agreed to have played a major role in this change. Likewise, courts will promote trust and cooperation if they read those norms into relational business contracts like strategic alliances.

Much of the debate over high or low fiduciary duties can be resolved by carefully examining the facts of the given case and striving to effect the parties' reasonable expectations. Courts should focus first on the parties' manifestations to

221. See Shishido, supra note 168, at 73.
223. See supra notes 146-49 and accompanying text.
224. FUKUYAMA, supra note 44, at 310-11.
225. Scott, supra note 94, at 615.
226. See Adler & Kwon, supra note 65 (manuscript at 11, 16).
each other when they contracted and on their course of dealing under the contract. The level of fiduciary duties imposed should then reflect the degree of trust and cooperation that the parties have indicated they want. Absent contrary evidence, courts should assume that the parties intended to maximize their wealth. 227

Although it is often hard to identify optimal gap fillers and fiduciary duties, courts should not abandon the effort and limit themselves to enforcing express contract terms. Mistakes will occur, but over time courts can correct mistakes and, until they do, it is easier for parties to contract around occasional mistakes than to contract around a judicial refusal to imply any terms at all. 228 Even if courts in some states poorly choose gap-fillers and fiduciary duties, parties can avoid these mistakes by a simple choice of law clause dictating that their contract be governed by the law of a state whose courts do a better job.

SPECIFIC PROBLEMS IN STRATEGIC ALLIANCES

As noted before, the facts surrounding a particular strategic alliance are generally more important than the allies’ choice of form of entity. 229 Accordingly, most of the following discussion focuses on particular issues that are common to all strategic alliances rather than on the form of entity. An exception is joint ventures.

JOINT VENTURES

Joint venturers owe each other the same fiduciary duties as partners do, except that duties concerning business opportunities and competition with the other party may be somewhat narrower due to the narrower scope of joint ventures. 230 When an alliance is incorporated as a “joint venture corporation” 231 the scope of fiduciary duties may be uncertain. In some states fiduciary duties in close corporations are the same as in partnerships; in others they are not. 232

Higher fiduciary duties are appropriate for partnerships in matters where the law subjects partners to greater vulnerability than it does shareholders of close corporations. For example, a partner is an agent with power to bind the partner-

227. See supra notes 112, 119-120 and accompanying text.
228. See Eggleston et al., supra note 24 (manuscript at 30) (asserting that parties are “likely to value legal gap-filling, if efficient and fair”).
229. See supra notes 213-16 and accompanying text.
230. See HARROCH, supra note 7, § 2.09(2), at 2-75 (“It is generally thought that a joint venturer’s fiduciary duty is somewhat more narrowly circumscribed than is the fiduciary duty owed by a partner to his co-partner, since a joint venture is typically created for a specific enterprise and is not intended to represent a continuing business relationship.”).
231. Id. at 2-75; see supra notes 7-8 and accompanying text.
232. Compare Donahue v. Rodd Electrotype Co. of New England, 328 N.E.2d 505, 515 (Mass. 1975) (“[S]tockholders in the close corporation owe one another substantially the same fiduciary duty in the operation of the enterprise that partners owe to one another.”) (footnotes omitted) with Nixon v. Blackwell, 626 A.2d 1366, 1379-81 (Del. 1993) (declaring “no special rules for a ‘closely-held corporation’”).
ship in its ordinary business;[^233] can dissolve the partnership at any time;[^234] and is personally liable for partnership debts.[^235] None of these is the default rule for corporate shareholders. Because partnerships are so easy to dissolve (at least under the old Uniform Partnership Act), courts imposed fiduciary duties to prevent opportunistic dissolutions.[^236] Such measures are less needed for corporations, which are more difficult to dissolve.

In most respects, though, shareholders of close corporations are just as vulnerable as partners, and few disputes between joint venture corporation shareholders concern matters in which the default rules for corporations and partnerships differ. Accordingly, there should be a strong presumption that fiduciary standards are the same for joint venture corporations as for "joint venture partnerships."

**Business Opportunities, the Scope of the Alliance and Exclusivity**

More litigation arises in strategic alliances over business opportunities and the scope of the alliance than any other issue.[^237] This fact reflects the difficulty of handling the issue by contract. Rapid technological change often blurs the line between different industries. Even alliances between huge, sophisticated companies can land in court. Pfizer and Warner-Lambert had a marketing partnership for Lipitor, the top-selling anti-cholesterol drug. When Pfizer made a takeover bid for Warner, Warner claimed that the bid violated their contract.[^238]

Allies in research and development are never sure what they will discover. Disputes can erupt about whether an unexpected discovery is within the scope of the venture. It is also hard to predict what opportunities partners will receive, so it is hard to define which opportunities belong to the alliance and which may be pursued independently or with a third party. Unless otherwise agreed, a joint venturer cannot compete with the venture, but it is often difficult to define a

[^233]: Unif. P'Ship Act (1914) § 9(1), 6 U.L.A. 400 (1995); Unif. P'Ship Act (1994) § 301(1) (amended 1997), 6 U.L.A. 33 (Supp. 2001); see Harroch, supra note 7, at 2-74 ("[E]ach joint venturer has the power and ability to bind the other joint venturer and to subject it to liability to third persons in matters which are within the scope of the enterprise.").


[^236]: See supra note 129.

[^237]: See supra note 1.

[^238]: See Warner-Lambert's Counter-Punch: Pfizer Broke Lipitor Pact by Making Merger Offer, Del. Law Wkly, Dec. 7, 1999, at 5. Warner also contended that Pfizer illegally used confidential information to make the bid. See id. Glover, supra note 1, at 7, also cites litigation between Universal Studios and Paramount.
market so as to determine whether some activity actually does compete with the venture.

Partners can address this problem by defining their alliance narrowly, but doing this may impair their cooperation and trust.239 A partner may withhold valuable information, for example, if it fears that the other party may use the information to pursue an opportunity on its own. A narrowly defined enterprise may be unable to adapt to changing markets and technology. For these reasons narrowly defined ventures tend not to succeed.240 Alternatively, an agreement can authorize the parties separately to pursue opportunities in the same field as the alliance or even to compete with each other.241 Such terms must be enforced with great care, though. It may be one thing for a party to pursue an opportunity that comes to it independently and quite another to seize an opportunity brought to the alliance by its partner.242

Apart from the parties' expressed intentions, the facts of the case may reveal their reasonable expectations about the scope of the venture. For example, if X knows that Y already has research and development projects with many other partners, X should realize that Y will not necessarily share all opportunities it gets with X. An absence of other alliances at the time of contracting does not mean that the parties intend exclusivity, however. Having alliances with several firms brings beneficial diversification. It avoids the risks of putting all one's eggs in one basket, including the risk that an exclusive partner will grow slack because it has no rivals, or will abuse its exclusive position by acting opportunistically. Moreover, one motive for entering an alliance is to exploit some expertise of another firm. Neither firm will want the alliance to extend beyond the scope of its partner's expertise. Thus allies may want to preserve the freedom to deal with others. However, courts should not generally assume that the parties intend a narrow scope for their venture. Business people usually favor a broader definition of the venture than do their lawyers, and many joint ventures fail or require difficult renegotiation because the venture was initially drawn too narrowly.243 Even an express definition of the scope of the enterprise could be disregarded if the parties' subsequent behavior shows that they have broadened the undertaking.

TERMINATION

If partners share the gains (or losses) of an alliance in the same proportions as their contributions, and if termination will lead to division of the surplus of the

239. Id.
240. See JOEL BLEEKE & DAVID ERNST, COLLABORATING TO COMPETE: USING STRATEGIC ALLIANCES AND ACQUISITIONS IN THE GLOBAL MARKETPLACE 18, 24-27 (1993) (basing this conclusion on a study of forty-nine alliances).
242. See Singer v. Singer, 634 P.2d 766, 772 (Okla. Ct. App. 1981), construing a term to allow some partners to seize an opportunity brought to the partnership by other partners. It is doubtful that the parties intended to allow this.
243. See ERNST & GLOVER, supra note 183, at 11.
alliance and of related business opportunities in the same proportions, termination of the alliance by a partner should not be a breach of fiduciary duty, but termination often does not meet these criteria. Sometimes partners make contributions at different times so that at a given time their capital accounts differ. A contract may also allocate more of the early gains (or losses) to one partner.\(^{244}\) Also, on termination the partners may not share the assets pro rata. For example, one may have a liquidation preference or be able to purchase the alliance’s assets at a bargain price. Lastly, termination may enable one partner to exploit opportunities that properly belong to the alliance.

Parties can avoid such problems with a well drafted termination clause,\(^{245}\) but they may not even try to draft such a clause because they want to foster trust and cooperation by avoiding hard bargaining.\(^{246}\) A partner who terminates an alliance may not intend to grab a disproportionate benefit, but in that case that partner can offer a settlement that treats its partner fairly.

Most distribution arrangements have no jointly-owned assets to dispose of, but termination may leave a party with uncompensated sunk costs (like advertising) or with assets of little value for any other use. Again, this does not necessarily mean the termination is opportunistic. For example, poor performance by one party may justify the other in terminating. A threat of termination may, however, be brandished against a partner on whom it would inflict serious loss in order to extract concessions.

“Courts have traditionally applied the rule of termination at will to exclusive agency and distributorship agreements.”\(^{247}\) The terminating party is usually required to give reasonable notice to allow the other party to recoup its sunk costs.\(^{248}\) Schwartz criticizes this rule because determining what is reasonable “requires unverifiable information.”\(^{249}\) This concern is legitimate but does not outweigh opposing concerns. Sunk costs of franchisees (and distributors and dealers) are often large.\(^ {250}\) Due to the costs and vagaries of litigation, terminated franchisees will not bother to sue unless their losses are substantial.

If a franchisee’s losses from abrupt termination exceed the gains to the franchisor, the termination is inefficient. If the franchisor’s gains exceed the franchisee’s losses, the franchisor should be willing to compensate the franchisee who has committed no wrong. If the franchisor is the larger party (as it usually is), indemnifying the franchisee for its losses beneficially spreads costs. Indemnification then becomes part of the franchisor’s cost of doing business, which is spread among all its franchisees. Because most franchisees (like other small busi-

\(^{244}\) See I.R.C. § 704(a) (1994) (permitting special allocation of gains and losses in partnerships).

\(^{245}\) See infra notes 270-71 and accompanying text (discussing Russian roulette buyout provisions); see Holmström & Roberts, supra note 17, at 84 (describing airline alliance contract requiring three-year notice for termination).

\(^{246}\) See supra notes 172-95 and accompanying text.

\(^{247}\) E. ALLEN FARNSWORTH, CONTRACTS § 7.17, at 556 (2d ed. 1990).

\(^{248}\) See Schwartz, supra note 222, at 306.

\(^{249}\) Id.

\(^{250}\) See supra note 27.
ness owners) are risk-averse, they will accept these costs as insurance against a devastating loss from an abrupt termination.

That a franchise contract does not expressly require reasonable notice of termination does not mean that the parties deliberately omitted that term. Most franchisees are too unsophisticated to appreciate the omission and too small to hire sophisticated counsel who would raise the issue. A franchisee who spots the issue may not mention it because to do so would spoil the optimistic atmosphere of negotiations and possibly signal to the franchisor that the franchisee is a troublemaker or does not expect to succeed. If a franchisee does express concern, the franchisor may well reply that it uses a standard form contract which it (understandably) resists altering for individual cases.

The franchisor may also say a written term is unnecessary because it cancels franchises only for good cause. This is usually true: franchisors have no reason to cancel a profitable franchise unless they find a better franchisee, so it makes sense that courts demand only good faith and reasonable notice for termination. Society benefits from a shift to a better franchisee, and a franchisor should be free to decide who is the better franchisee so long as it acts in good faith with reasonable notice. Unfortunately, Congress and many state legislatures have bowed to well-organized franchisees (who outnumber franchisors) by imposing onerous and inefficient limits on franchise terminations.

Many disputes in alliances concern the need for further financing. One motive for entering an alliance is to utilize another's financial resources, but a financial imbalance between the partners can be a problem when more capital is needed. This, too, is hard to handle in advance by contract—the decision of whether (or how much) to contribute further to a venture involves too many subjective variables to be reduced to a contractual formula. Without a contract term, though, one party may exploit the need for more money to terminate opportunistically or to extract unfair concessions. Even if the parties agree that more capital is desirable, one may be unable to pay its share. Sometimes third-party funding is available, but one party may bar it either in good faith or opportunistically.

Thus, for various reasons courts should be ready to halt an unfair termination, not only to do justice in the given case, but also to enhance the stability of alliances generally. The power to dissolve without fiduciary restrictions invites opportun-


252. See Schwartz, supra note 222, at 306 (courts require only reasonable notice before termination). In one study "[f]ranchisors had terminated less than one-third of one percent of their franchise agreements over a ten-year period." Dnes, supra note 194, at 373 (footnote omitted). They prefer to "buy out any franchisee who is considered unsuitable." Id.

253. See Harrigan, supra note 13, at 68-69.

254. Some contracts, however, do commit the parties to furnish further funds and provide that if a party fails to do so, its profit share will be reduced. See Glover, supra note 1, at 8.

255. See Harrigan, supra note 13, at 68-69, 366-67 (stating the need for further financing may alter division of control).
ism. At the least, courts should prevent termination in bad faith, even if the contract allows termination for any reason.

Terminating an alliance, however, may be warranted even if it is harsh to the partner. For example, termination may impose a loss on a franchisee who has acquired assets that cannot be used elsewhere. A court may then be tempted to enjoin the franchisor from terminating because of a minor breach by the franchisee. Franchises, however, are often used when performance by the manager of an outlet is hard to monitor and breaches hard to detect. Therefore, franchisors justifiably want a right to terminate even for minor breaches so as to deter widespread breaches by franchisees. In return franchisees are often allowed superior profits. If courts forbid termination in such cases, the parties will draft alternate contracts that are inferior for both.

**Contract Revision**

A problem related to termination arises when one partner seeks revision of the contract. The law rarely requires a party to agree to a revision or even to discuss revision in good faith despite changed circumstances. Indeed, a major purpose of contract is to shift risks. This purpose is defeated if a party can demand revision whenever changed conditions increase the burden of the contract on that party.

There are exceptions to the general rule, though. Courts excuse nonperformance because of "impossibility" or "frustration of purpose," concepts often liberally extended to cases where performance has simply become more costly to one party or less valuable to the other than originally expected. These doctrines are particularly important for long-term contracts that involve complex performance so that it is difficult to draft for all possible future contingencies. Partly for this reason some contracts provide for revision or renegotiation in certain circumstances, and parties often revise long-term contracts even absent a legal duty

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256. See Frankel, supra note 110, at 9 ("When the relationship can be terminated without serious adverse effects, interdependence and verification will be weak, and the parties are more likely to renege on their promises as more attractive opportunities come along."); see also Naomi R. Lamoreaux, *Constructing Firms: Partnerships and Alternative Contractual Arrangements in Early Nineteenth-Century American Business*, 24 Bus. & Econ. Hist. 43, 68-69 (1995).

257. See Klein & Murphy, supra note 37.

258. Id. at 267-68.

259. Gillette states:

For example, if a buyer and a seller enter a long-term supply contract at a fixed price on the explicit understanding that the latter believes the contract price will exceed the future spot price while the buyer forecasts the opposite, it would disrupt the very function of the transaction to require adjustment by the party whose prognostication proves correct in order to rescue the party who guessed wrong.

Gillette, supra note 75, at 539.


to do so.\textsuperscript{262} Parties to a long-term contract often do not expect it to be followed precisely; it is, rather "a frame-work highly adjustable, a frame-work which almost never accurately indicates real working relations, but which affords a rough indication around which such relations vary, an occasional guide in case of doubt, and a norm of ultimate appeal when the relations cease in fact to work."\textsuperscript{263} A party can also request a revision to expand the alliance.\textsuperscript{264}

Courts should always be cautious about compelling renegotiation.\textsuperscript{265} A claim of unexpected conditions requiring revision may be false, a pretext for escaping the intended bargain.\textsuperscript{266} Renegotiation is also costly and rarely increases total returns to the parties; it merely redistributes gains and losses between the parties. For several reasons, though, courts should more readily compel renegotiation or revision of strategic alliances than of routine sales contracts. Because alliances are so complex, it is more likely here than elsewhere that a request for a revision truly stems from developments that could not reasonably have been covered in advance rather than from a false claim of unexpected changes or negligence in negotiating the initial contract. Alliances also have a special need of trust and cooperation, which are enhanced if the parties can safely expect that their contract will be revised if unexpected conditions arise.

A related problem is determining when parties have implicitly revised a contract. One party may, for example, render performance not required by the contract or overlook the other party's failure to render performance. Again, the key question is what are the parties' reasonable expectations. Ordinarily one who voluntarily renders services to another is not entitled to compensation, even if the other knows of the performance, because knowledge and failure to protest alone do not imply willingness to pay for services.\textsuperscript{267} As between strangers, it makes sense to require clear consent as a condition to a duty to pay.

Strategic alliances, though, entail close dealings and heavy reliance on good faith, trust and cooperation. Courts would promote efficiency by setting a lower standard of consent in alliances, thereby sparing parties the high cost of formally renegotiating their contract whenever an amendment is mutually desirable. To do otherwise would discourage trust and cooperation in alliances by rewarding those who exploit a partner's trust.

**LOCK-INS AND BUYOUTS**

The opposite of the problem of opportunistic termination is lock-in: a party who wants to exit a venture may be unable either to dissolve the venture or to

\textsuperscript{262} See Gillette, supra note 75, at 536-37.


\textsuperscript{264} See, e.g., U.S. West, Inc. v. Time Warner, Inc., No. CIV.A.14555, 1996 WL 307445, at *9 (Del. Ch. June 6, 1996) (stating that a partner may take a corporate opportunity if the partners cannot agree on a price at which the partner will transfer the opportunity to the partnership).

\textsuperscript{265} See Baird, supra note 92, at 595-96 (arguing against a duty to renegotiate and revise).

\textsuperscript{266} See id., at 586-87; see also Scott, supra note 94, at 612-14.

\textsuperscript{267} See id.
sell its interest therein. This is less of a problem in general partnerships (including joint ventures) at will because a partner can dissociate at any time. In an incorporated alliance, though, a participant-shareholder may not be able to dissociate. In a contractual alliance, a party may be locked in by a term clause. One party may want to exit because it thinks that the other is acting illegally but that the illegality can not be proved (or is too expensive to prove) in court. A party may want to cash in its interest in a venture in order to pay debts, invest in other projects, or retire (in the case of an individual) or liquidate (in the case of a business entity).

The lock-in problem can be handled by contract. An ingenious solution is the Russian roulette buyout clause in which either party may demand dissolution and name a price for the venture. The other party must then either sell its own interest to the first party at the price named or buy out the first party at that price. This resembles the classic method for dividing a pie fairly—one party slices the pie, the other then gets to choose his piece. In both cases the first party is motivated to divide fairly because the other will pick the better piece if the pieces are disproportionate. Moreover, in a Russian roulette buyout parties are deterred from dissolving at all without good reason because the value of alliances is usually uncertain; even a price named in good faith may prove to be a costly mistake.

One problem is that a Russian roulette buyout does not work for a party who cannot afford to buy out its partner. If, say, one party has a twenty percent interest in a venture it values at $100 million, it can invoke the buyout clause only if it can raise $80 million. This solution also does not work in ventures with more than two parties. Further, even when a Russian roulette buyout seems appropriate, parties often do not contract for it.

A variant of lock-in occurs when a third party offers to buy the whole enterprise and one owner favors the offer but the other vetoes it so the proponent is locked in. This can be avoided by agreeing that one who rejects a sale of the venture must offer to buy out the other at the offered price. Absent such a clause, the opponent might refuse to do this because it lacks the needed funds, does not want to concentrate too much on one enterprise, or does not want to lose the partner's expertise. Given the ease of making such a contract, courts should not

268. See supra note 234.
269. "Termination clauses were treated as very important by lawyers. In a typical agreement document, approximately 80 percent of the joint-venture agreement's content was devoted to questions of who would buy out whom, at what price, and who would act as source to whom after the venture terminated." HARRIGAN, supra note 13, at 365. In one study seventy-five percent of joint ventures ended with a buyout. Id. at 4. Most joint ventures have no exit mechanism, though. See Glover, supra note 1, at 8.
270. See HARRIGAN, supra note 13, at 99 (describing the arrangement).
271. A party who can not get this amount can seek a third party to, in effect, buy out the partner or the whole venture. To find a buyer is hard, though, because the partner has a right of first refusal. A potential buyer knows it can buy the partner's interest (or whole venture) only if it offers a price the partner thinks is too high; and the partner almost surely knows more about the venture than the potential buyer, an outsider.
272. See DAVID J. GLADSTONE, VENTURE CAPITAL HANDBOOK 148-49 (describing such an "unlocking clause") (1988).
require a partner who vetos a sale to buy out the other unless there is such an agreement or the veto is shown to have been made in bad faith.

In another variant, the majority owner sells its interest to a buyer who does not offer to buy out the minority owner. In a partnership (including a true joint venture) such a sale is impossible because partnership status cannot be transferred (and a new partner admitted) without the consent of all partners. In other entities, though, such a sale may be permissible.

In corporate law a sale of control that excludes minority shareholders is generally legal. This makes sense: minority shares are inherently worth less than control shares, and investors should realize this at the outset. If they wish, they may agree to a "tag-along" or "take-me-along" clause that requires inclusion of the minority partner on equivalent terms in any such sale. Again, given the ease of adopting such a clause, courts should not impose a tag-along requirement unless sale of control will inflict some unusual damage on the minority.

**Judicial Remedies**

Easterbrook and Fischel inter alia argue against liberal use of judicial remedies to resolve disputes in business entities: "Restrictive legal rules concerning involuntary dissolution . . . create incentives for the parties to establish less expensive methods of adjusting conflicts." While there are often cheaper ways of resolving disputes than litigation, it does not follow that courts should just refuse to do more than enforce contracts. One party to a dispute may simply be unreasonable. Moreover, the burdens of an unresolved dispute may fall unequally on the parties. If, for example, one party is nearly bankrupt, the other party may exploit the chance to extract one-sided concessions. Such opportunism can also injure innocent third parties, like employees, customers and suppliers of the disputants. Their interests, too, argue against leaving the parties to stew in their own juices.

Moreover, "less expensive methods of resolving conflicts" are not limited to highly detailed contracts. Many contracts are vague on many points but provide for arbitration, which is basically litigation in a different forum. Arbitrators do not simply enforce explicit terms; they also fill gaps in contracts. There is no

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274. See Harry G. Henn & John R. Alexander, Laws of Corporations § 241, at 657 (3d ed. 1983) ("Shareholders generally . . . may sell their shares for whatever price they can get, and a controlling block of shares as a practical matter usually can be sold at a higher price per share than other shares.").


reason why courts cannot do likewise when parties do not contract for arbitration. If courts refuse to do so, they only constrain contracting parties to resolve disputes by means that are inferior to a well-functioning court system.\textsuperscript{278}

Of course, fashioning remedies is not easy. A court must decide whether an alliance should be salvaged or ended. Only soured relationships wind up in court, and litigation exacerbates hostility. Like married couples, though, partners can sometimes squabble without divorcing. Some disputes cause one or both parties to dig in their heels rather than to seek compromise. One party may seek dissolution because it expects to profit from it. If a court indicates that the terms of dissolution will not be what that party hoped, it may lose its appetite for dissolution.

On the other hand, a party may act badly (provoking deadlocks, etc.) to goad its partner to seek a dissolution from which the former expects to benefit. A court can foil this gambit by granting relief other than dissolution or by granting dissolution on terms different from those the first party expected. Again, if the court hints at such a result, the obstreperous partner may become more cooperative.

Such a change of heart is not implausible. An alliance is born because the parties thought it would create value. That they are at odds does not mean they were wrong. Salvaging even a marginal alliance may be better than incurring the cost of ending it. Of course, an alliance is unlikely to succeed if even one party wants to end it. Again, though, during litigation both parties may come to favor a reconciliation. Courts can encourage this by actively promoting settlement—not merely exhorting the parties to work things out themselves, but seeking the source of the dispute, admonishing realism over the likely result if the case is not settled, and exploring possible terms of settlement.

A court may also grant relief that does not end the alliance by dissolution or a buyout. It may, for example, appoint a custodian or temporary director to resolve deadlock or curb oppression of a minority partner.\textsuperscript{279} Fear of management by a stranger may prod partners to compromise. Even if they still cannot settle the dispute themselves, they may be able to cooperate again after the court-appointed caretaker has resolved the disputed issues.

If dissolution is ordered, courts must be careful about its terms. A procedure that superficially looks neutral may really be unfair. For example, take the usual way of liquidating a partnership by selling its assets at auction.\textsuperscript{280} Some assets (like a firm’s reputation with customers) have a lower value to outsiders or (like

\textsuperscript{278} Perhaps litigation should be discouraged because the judicial system is a public expense. The public purse, however, can be conserved in better ways, as by requiring litigants who are able to pay the court costs they generate. Moreover, litigation produces some positive externalities, such as announcing default rules that make it easier for private parties to contract. See supra note 206 and accompanying text.

\textsuperscript{279} See HENN & ALEXANDER, supra note 274, § 277, at 748-49 (discussing appointment of provisional directors).

\textsuperscript{280} UNIF. PARTNERSHIP ACT (1914) § 38(1), 6 U.L.A. 880 (1995) provides that on dissolution any partner who has not wrongfully dissolved may demand that the surplus (if any) be distributed “in cash.” “In effect, this gives each partner the right to force a sale of the partnership assets. . . .” J. DENNIS HYNES, AGENCY, PARTNERSHIP, AND THE LLC IN A NUTSHELL § 94, at 188 (1997).
much intellectual property) are hard for outsiders to appraise. These assets are unlikely to fetch a fair third-party bid. If one party lacks funds to bid the fair value of the assets, the other may be able to grab them at auction for a low price. To prevent this, a court can fashion different relief—like permitting or requiring one party to buy out the other.281

Determining the parties' rights in specific property or in any surplus can also be difficult. Property lent to a partnership is returned to the lender; the lender gets the benefit of any increase in its value. If property is given to the firm as a capital contribution though, the capital account of the contributing partner is credited with the value of the property at the time of the contribution;282 that partner gets only a pro rata share of any appreciation of the property. Whether property is deemed loaned or contributed depends on the intent of the parties, but their intentions may be unclear; one or both parties may not (or claim they did not) understand the difference, or they may simply neglect to express their intentions.

A third difficulty under partnership law is that, unless otherwise agreed, capital contributions are repaid after dissolution, the remaining surplus is divided equally, and partners get no compensation for services to the partnership.283 The rules are different for corporations, in which at dissolution shareholders divide the assets according to share ownership regardless of the price paid to the corporation for the shares.284

Suppose, for example, that X contributes laboratory equipment worth $1 million and Y provides research worth $1 million. The project obtains a patent which is sold for three million dollars. If the project is incorporated with X and Y as equal shareholders, each gets $1,500,000. But if the project is a joint venture governed by partnership law, X first gets back $1 million for its capital contribution of equipment; Y gets no capital credit for its services. The remaining $2 million is deemed profit and divided equally. This could be what the parties intended, but Y may have expected to be treated the same as X, as would be the case if the venture were incorporated with Y as an equal shareholder.

The three foregoing problems can combine with devastating results. Suppose X provided ideas and research and Y contributed $30 million to a joint venture. The venture obtained a patent (its sole asset) now worth $100 million; there are no debts. There is no contrary agreement, so on dissolution the patent is auctioned off. X has little money or credit and can find no backer to bid more than $30 million for the patent, so Y buys the patent at the auction for $30 million. Y's

281. This is being done with greater frequency in close corporations. See Thompson, supra note 109, at 231.


284. See HENN & ALEXANDER, supra note 274, § 382, at 1148 (stating that on dissolution, after payment of senior claimants, surplus is divided "pro rata among the rest of the shareholders").
capital account is $30 million—the amount of its capital contribution. X's research
receives no capital credit and its ideas are not deemed property, so its capital
account is zero. Capital accounts are repaid first, so the entire $30 million from
the auction goes back to Y, which now has a patent worth $100 million at a cost
of $30 million; X gets nothing for its efforts. Even if X's ideas were deemed
property contributed to the venture, they would be appraised as of the time of
the contribution, when their value might have been quite low.

X is better off if the venture is incorporated with X and Y as equal shareholders.
They would then share the $30 million equally. Moreover, under most state laws Y
could not dissolve the corporation unilaterally, as it can if the venture is a partner­
ship. X might be able to block dissolution and thereby extract a better deal from Y.
If X is in financial straits, though, it may have to accept an unequal division of the
profits. An assertive court could impose a fairer result. First, it could order Y to buy
the patent for its fair value of $100 million. Second, even under partnership law a
court could find an implied agreement to split this amount equally rather than giv­
ing Y a preference for its $30 million cash contribution.

What should a court do absent clear evidence beyond the circumstances of the
parties? Because the parties agreed to split profits equally (either by express con­
tract or by virtue of the default rule), they probably valued X’s ideas and services
as equal to Y's cash contribution. It is most unlikely that X intended Y to be
able to grab an asset worth $100 million for $30 million. A court may not need
impose this result through a final judgment. If the court makes clear that Y
cannot grab the patent with little or no payment to X, Y may agree either to
continue the venture with X or to pay X fair value. To do otherwise and press for
unilateral advantage would risk further delay and costly litigation and damage to
Y's reputation.

An equal split also makes economic sense. It encourages trust and obviates
costly drafting and bargaining that erodes trust. In other words, it promotes the
formation of wealth-creating ventures. Although this result is less profitable to Y
than traditional partnership rules would produce, it should not discourage Y from
entering into alliances. If this is not a result Y would have agreed to, it can easily
insist on a specific contract providing for a different result.

285. A court could reach this result by finding a tacit agreement to give X a capital credit of $30
million for its research and ideas. In the extreme a court could find that X merely lent its ideas to the
joint venture and that these ideas, including the patent that grew out of them, must now be returned
to X. The venture then has no assets and has suffered a total loss of its $30 million of capital—i.e.,
of Y's contribution. X, having made no contribution itself, would have to pay Y $15 million to equalize
their losses. See UNIF. P'SHIP ACT (1914) § 18(a), 6 U.L.A. 526 (1995) (providing that partners share
losses equally unless otherwise agreed); see also UNIF. P'SHIP ACT (1994) § 401(b) (amended 1997), 6
would still be much better off than in other scenarios. It is unlikely that a court, however, would find
that the original ideas, much less the patent that grew out of them, were property belonging to X.

286. Again, this would be the default result if the venture were incorporated with X and Y as equal
shareholders.
PAYOUTS

In neither partnership nor corporation law is a participant automatically entitled to payouts from profits. Payouts must usually be authorized by a majority vote—of partners in a partnership, of directors in a corporation. This requirement generally makes sense but can produce unfairness. Suppose X and Y are equal owners in a new firm which after six months has a $200,000 profit. X needs money for personal and family expenses. Also, if the firm is a partnership or is taxed like one, X must pay income tax on her $100,000 share of the profits even if she has received none of it. Y, however, vetoes any payout. Y may just prefer to reinvest the profit in the firm, but Y could also use the veto as a ploy to extract concessions from X. Unless X can prove in court that Y is acting in bad faith, X is probably not entitled to any legal relief. Even if X can show bad faith, she may not be able to wait for judicial relief. In either case she may be forced to make concessions to Y in order to get a payout.

The same problem can arise in an alliance between firms. One firm may need money to pay creditors, including employees. Here too a denial of payouts will disappoint the party's reasonable expectations. The lack of a contractual formula for payouts does not necessarily belie such expectations. Formulas are difficult to draft. Many venture agreements do require payouts of a specified portion of profits to cover the owners' taxes thereon, but even these provisions are an exception, and requirements for higher payouts are rare, being generally limited to entities with predictable income and expenses.

Courts can prevent such oppression if they will go beyond traditional rules. One remedy is court-ordered dissolution with X being cashed out. The mere threat of judicial dissolution may persuade Y to approve reasonable payouts. If it does not, a court can impose a payout policy. This poses some of the same problems that arise in drafting a contractual payout policy. A court, however, can amend an order in light of later events; revising a contract, by contrast, requires the consent of all parties, some of whom may behave strategically. Moreover, owners can escape a court-dictated payout policy by reaching their own agreement at any time. Thus, it again makes sense for courts to act on their best estimate of the parties' reasonable expectations. This approach is not only best for the parties before the court but also minimizes the cost of drafting complicated payout formulas that, despite best efforts, may not work very well anyway.

GOAL DEFINITION

Parties to a strategic alliance may disagree about goals. Even when they share from the same pool of profits, they may disagree about risk or the desired timing
of profits. Such disagreements rarely threaten to destroy an alliance, though. In litigation courts can reasonably assume that the parties intended risk neutrality and maximization of net present value unless a contrary intent is shown.

Disputes over goals arise more often if the parties are not just sharing a single pool. One party may have separate interests that conflict with the goal of maximizing the value of the joint enterprise. For example, research may point toward a new product that would compete with an existing product owned by one of two equal parties. That party may oppose development of the new product, from which it would get only half the profits, at the expense of the existing product, from which it gets all the profit. Each party has a general right to expect that its partner will not hamper the alliance solely to protect an existing product.

In some cases, though, this expectation may be unreasonable. For example, should a manufacturer expect its distributors not to sell competing products? The answer is usually no, but much depends on the specific facts. Another problem arises when parties do not get constant, fractional shares of profits. For example, a distributor may pay the manufacturer a fixed price for a product and keep all the profit from resales. The manufacturer then will want to maximize sales—for example, by minimizing resale prices. The dealer wants to maximize its profit, which may dictate higher resale prices than the manufacturer wants.

In neither of these cases is it reasonable to assume that the dealer will fail to maximize the parties' joint profits if the dealer acts so as to maximize its own profit. Accordingly, a manufacturer has no right to expect a dealer to curb its profits for the benefit of the manufacturer, and courts should not require the dealer to do so. If a manufacturer wants a dealer so to behave, it should specifically contract for such a duty.

THE ROLE OF LAWYERS

For lawyers, negotiating strategic alliances is unusually tricky. Most alliances are major, complex, long-term transactions whose contracts require great care. Lawyers play a crucial role in focusing clients on difficult contractual issues. The usual behavior of lawyers, however, does not enhance the trust that allies want and need. This is not surprising. Rules of professional responsibility direct

290. See supra notes 196-98 and accompanying text.
291. See JOHN E. MURRAY, MURRAY ON CONTRACTS § 58, at 221 (3d ed. 1990).
292. See Rubin, supra note 29, at 229; Klein & Murphy, supra note 37, at 270-76 (discussing maximum resale price provisions).
293. Some contracts specify the level of effort a distributor is required to make. See GUTTERMAN, supra note 5, at 10.018-10.020; Bloor v. Falstaff Brewing Corp., 601 F2d 609, 613-15 (2d Cir. 1979) (stating that a beer distributor was not required "to bankrupt" itself promoting products for which it had promised to maintain a "high volume of sales," but it did have to take measures inconsistent with maximizing its profits).
295. See supra notes 183 and 187 and accompanying text.
lawyers to represent their clients zealously. The rules do not require lawyers to seek maximum advantage for the client or to insist that every possible contingency be covered in contracts, but they breed attitudes and habits that incline to such behavior. Law schools encourage these attitudes by stressing litigation. Professional competition among lawyers for money, influence, and prestige reinforces these attitudes. In many areas of practice—not only in litigation but also in many business transactions—these attitudes and habits are useful. In many financings, of mergers and acquisitions, for example, the parties will not deal with each other at all, or not in a way that requires trust and cooperation, after the contract is signed. In such cases, a lawyer's aggressive tactics may serve the client well.

Aggressive lawyers, however, can erode the trust needed for a successful relational contract. It is not surprising, then, that business people pursuing such a contract tend to exclude lawyers as long as possible and then minimize their participation. Ideally, lawyers would participate fully in negotiations, but would act so as to enhance trust. To do so, lawyers would have to overlook issues they would ordinarily raise and make concessions that they would ordinarily resist. They would offer compromises rather than waiting for the other side to offer them. The small, close-knit group of Silicon Valley lawyers specializing in venture capital financing seem to have embraced these attitudes.

This behavior will not come easily to many lawyers, not only because it is so atypical but also because it runs against the natural inclination to seek a larger fee by raising as many issues and fighting on them as long and as hard as possible. In the long run, though, lawyers—both individually and as a profession—may gain from becoming more cooperative. As they do so, clients will involve their lawyers sooner in order to enjoy their help in achieving the agreement that maximizes their mutual interests.

The rapidly growing use of in-house corporate lawyers stems in part from their more constructive attitude, a result of the keener acculturation of in-house lawyers to the company's business needs. When house counsel is unavailable, clients can encourage constructive behavior by giving their lawyers appropriate instructions. These instructions should be communicated to the other side so that all understand that a lawyer's cooperation is not a sign of incompetence or weakness.

Contracting parties may even want to use one lawyer as mediator rather than two lawyers as advocates. Professional rules permit lawyers to play this role and

296. See Model Rules of Prof'l. Conduct R. 1.3 cmt. (1) (1996) ("A lawyer should act . . . with zeal in advocacy upon the client's behalf.").
297. See supra note 187 and accompanying text.
298. See Suchman & Cahill, supra note 294, at 700, 704. In this group conditions are unusually favorable for the flourishing of these norms: the practice is heavily concentrated in a small geographical area, the main players know and repeatedly interact with each other, and contract terms are becoming standardized. Id. at 690, 701-04, 706-09. These conditions do not hold for lawyers involved in strategic alliances.
299. Not surprisingly, social scientists have found that people are more likely to cooperate when they are instructed by an authority to do so. See generally David Sally, Conversation and Cooperation in Social Dilemmas: A Meta-Analysis of Experiments from 1958 to 1992, 7 Rationality & Soc'y 58, 78 (1995) (summarizing results of prior studies).
they often do so when individuals want to set up a business.\footnote{300} Again, this may only seem to shrink the role and fees of lawyers. Unlike many business people, good business lawyers are experienced negotiators and drafters. If lawyers act constructively, clients have every reason to maximize their role.

**Conclusion**

The need for businesses to innovate continuously and rapidly in a high-technology global economy has precipitated a proliferation of strategic alliances. This development presents the law with what is in effect a new form of business entity. Although most partners in strategic alliances are themselves business firms and generally competent to defend their own interests, the complexity of strategic alliances makes it inevitable that contracts by which they are created will exhibit large gaps. Because of these gaps, the parties must rely on trust and cooperation to succeed. Fear that one's partner can act opportunistically without penalty undermines trust and cooperation.

Accordingly, courts play an important role in supplying the gap-filling default rules and fiduciary duties for strategic alliances. The courts' task is complicated by the division of alliances into many categories—including joint ventures, franchises, dealerships, distributorships, licensing arrangements, and "strategic investments"—and by the remarkable variety of relationships within each of these categories. With careful attention to the facts of each case, courts can fashion rules that curb opportunism in strategic alliances without imposing burdens that prevent joint wealth maximization. By so doing, courts would boost the growth of this crucial sector of the economy by making it easier to draft contracts for strategic alliances and less dangerous to sign them.

\footnote{300. \textit{Model Rules of Prof'L Conduct} R. 2.2(a) (1996) ("A lawyer may act as intermediary between clients if" certain conditions are met.).}