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## ENDURING DESIGN FOR BUSINESS ENTITIES

William E. Foster\*

### *Abstract*

*The success or failure of an institution may hinge on some of the earliest decisions of its founders. In constitutional design literature, endurance is a widely accepted drafting objective. Indeed, constitutional endurance is positively associated with prosperous and stable societies. Like drafters of constitutions, business organizers have almost innumerable objectives for their enterprises, and attorneys drafting organizational documents must take into account these myriad goals. Oftentimes the drafting process fails to fully address some of the most important of these aims, which results in suboptimal structures that lack predictability and reliability.*

*This Article looks specifically at small-business organizations and argues that drafters can draw from the lessons of constitutional design to facilitate a more deliberate drafting process that would result in more predictable business institutions. Such a process would accommodate a more thorough bargaining process among organizational founders and enhance the effectiveness of its governing documents. Certain design elements are correlated to constitutional endurance, and those elements can guide the drafting process for business associations. Specifically, longer-lived constitutions incorporate flexible amendment procedures, involve a greater number of constituents in the drafting process and enforcement processes, and offer more detail and specificity in the governing provisions. Business entities can use some of these same features, and this Article offers specific suggestions for incorporating the elements associated with endurance into business drafting. By crafting organizational structures with elements that parallel those of long-lived constitutions, business attorneys can facilitate a more thorough bargaining process and craft more usable, resilient documents that effectively address unique client objectives.*

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## I. INTRODUCTION

Current approaches to organizational design and drafting for business entities are problematic in a number of important ways, resulting in structures and documents that fail to reflect unique client objectives, are disproportionately advantageous to particular types of participants, and lack practical functionality. Attorneys tasked with forming businesses must address dozens of organizational and operational choices—from tax status to voting mechanics to allocation and distribution priorities to dissolution procedures—and must draft documents consistent with the organizers’ goals.<sup>1</sup> In crafting these agreements, business lawyers typically work from form contracts or precedent documents from prior similar entity formations.<sup>2</sup> This reliance on established provisions is almost essential, as the cost of creating complex agreements entirely from scratch or even a checklist would be both cost prohibitive and needlessly risky.<sup>3</sup> Form documents themselves serve as checklists of major decision points because in reviewing each contractual section, the attorney has to decide whether to retain the standard language or revise it according to the specific bargain at hand.<sup>4</sup>

Unfortunately, this practice of reliance often leads to complacency, thoughtless retention, redundancy, and recondite intricacy in the final product.<sup>5</sup> Although it is true that many standard contractual provisions do not need to be reworked for each operating agreement, when attorneys begin the drafting process by modifying a contract designed for a different bargain, too frequently the precedent provisions carry unjustified authority.<sup>6</sup>

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<sup>1</sup> William A. Klein & Eric M. Zolt, *Business Form, Limited Liability, and Tax Regimes: Lurching Toward a Coherent Outcome?*, 66 U. COLO. L. REV. 1001, 1001 (1995) (“Assisting clients in forming business associations, a lawyer will focus on various substantive elements: the duration of the relationship and the circumstances and terms of termination; the division of investment, distributions, gain, and loss; exercise of control, including management positions and voting mechanisms; and so forth, depending on the particular project or enterprise.”).

<sup>2</sup> See Karen Eggleston et al., *The Design and Interpretation of Contracts: Why Complexity Matters*, 95 NW. U. L. REV. 91, 113 (2000) (“Form contracts are common. Often, they are produced by trade associations; parties rely heavily on the form and make minor adjustments to suit their circumstances. At other times, a large business uses the same contractual form for multiple customers.”).

<sup>3</sup> Lawrence A. Cunningham, *Language, Deals, and Standards: The Future of XML Contracts*, 84 WASH. U. L. REV. 313, 327–28 (2006) (discussing how costs associated with composition and review of contracts can be reduced by replicating terms despite issues of “oversimplification or excess complexity” and that “[m]aking changes often entails creating numerous internal cross-references in contracts”); Claire A. Hill, *Why Contracts Are Written in “Legalese,”* 77 CHL.-KENT L. REV. 59, 60–64 (2001) (discussing the economical and psychological dynamics of the business contract drafting process).

<sup>4</sup> Hill, *supra* note 3, at 67 (“The form provides a baseline from which to determine what the contract should address.”).

<sup>5</sup> See *infra* Part II.B.

<sup>6</sup> Hill, *supra* note 3, at 75 (“The status quo bias favors, not surprisingly, the status quo.”).

Accordingly, organizational documents often contain almost identical features regardless of the distinct positions of the individual founders.<sup>7</sup> Further, partnership and LLC entity agreements typically include needlessly intricate provisions that merely state the statutory default rules or are so self-referential or convoluted as to require extensive study in order to be meaningful.<sup>8</sup> The functionality of these provisions is further impaired by the fact that different law firms, and even different lawyers within individual firms, use widely divergent language to articulate the same concepts.<sup>9</sup>

Many of the issues manifested in organizational agreements result from a relatively unguided drafting process.<sup>10</sup> Aside from perhaps a few anticipated funding or performance hurdles they might want addressed, clients largely defer to attorneys to provide the decision points and appropriate approaches. As a result, few clients are fully informed as to the organizational choices reflected in the document and their concomitant rights and obligations.<sup>11</sup>

This Article suggests a more focused and intentional drafting process for the design of business entities and the drafting of organizational documents, specifically through the lens of endurance. Although stakeholders in a newly formed entity often have widely divergent expectations with respect to the length of their investment and commitment, endurance should be a guiding objective for business drafters in many situations. Drawing from institutional design research, this Article suggests certain design elements that can facilitate longer-lived organizational documents.<sup>12</sup> Even if a long-lived institution is not the primary goal of the founders, incorporating the design elements associated with enduring constitutions can facilitate intentional drafting that results in more predictable and usable documents for the business.

In constitutional design literature, endurance (i.e., longevity) is a widely accepted objective for drafters of constitutions.<sup>13</sup> Indeed, longer-lived constitutions

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The form—the way things have been done in the past—counts as the status quo for this purpose; the bias is towards retaining the status quo rather than changing it.”).

<sup>7</sup> See *infra* Part II.B.

<sup>8</sup> For example, many pass-through entities contain labyrinthine partnership tax provisions, which ultimately defer to the Treasury Regulation’s requirements for maintenance of capital accounts. Cf. Terence Floyd Cuff, *Drafting Real Estate Partnership and Entity Agreements*, L.A. LAW., Jan. 2006, at 12, available at <http://www.lacba.org/Files/LAL/Vol28No11/2215.pdf>, archived at <http://perma.cc/XLV3-ZJE4> (“Partnership agreements too often suffer from the arrogance, complacency, incompetence, false economy, and inattention to detail of drafters.”).

<sup>9</sup> See Hill, *supra* note 3, at 59 n.2. (“In my experience, some law firms have aspired to, but never quite achieved, the goal of having a firm-wide form. It’s not as though the forms used within a firm, or for that matter, by different firms, differ enormously *in content*; they do, however, *look* quite a bit different. The provisions might be phrased differently or be in a different order.”).

<sup>10</sup> See *infra* Part II.A.

<sup>11</sup> See *infra* Part II.B.

<sup>12</sup> See *infra* Part V.

<sup>13</sup> See ZACHARY ELKINS ET AL., *THE ENDURANCE OF NATIONAL CONSTITUTIONS* 10 (2009) (“Written constitutions are central institutions in the political order and powerful

are associated with highly desirable economic, social, and political outcomes.<sup>14</sup> This Article first explores whether institutional endurance should similarly be a goal of organizers of business entities. It concludes that, although businesses differ in key (and obvious) respects from nation states, constitutional design literature can inform the methods employed by business drafters. A drafting approach that mirrors the constitutional bargains that produce longer-lived documents can alleviate some of the current shortcomings of business institutional design.<sup>15</sup> Benefits accrue even if the goal of the founders is not an enduring organizational structure because approaching institutional design from an endurance perspective requires drafters to be thoughtful and thorough in creating a document that meets the needs of the clients.

This Article continues with a discussion of how the objective of endurance should promote thoughtful drafting. The constitutional design literature posits that certain design elements are correlated to constitutional endurance.<sup>16</sup> Specifically, longer-lived constitutions typically have a flexible amendment procedure, involve a greater number of individuals in the drafting process and enforcement, and offer more detail and specificity in the governing provisions.<sup>17</sup> Business organizational documents can utilize some of these same features, and this Article offers specific suggestions for incorporating these elements into business drafting.

For example, flexibility of amendment procedures can translate into the business context.<sup>18</sup> Constitutions that are easily amended last longer because they can adapt to changing conditions that deviate from the expectations of the constituents.<sup>19</sup> Similarly, when a business needs an unexpected infusion of capital, market competitors change their positions, or members unexpectedly depart, the entity needs the ability to adapt to the change. The flexibility to address these issues can be incorporated in a variety of ways, one of which is the amendability of the structure of the bargain itself. Flexibility to adapt to changing conditions can also be addressed via transfer restrictions and other provisions that reflect the relative commitment of the individual investors to the bargain.<sup>20</sup>

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symbols of statehood. As a normative matter, most designers and scholars seem to assume that they should endure.”).

<sup>14</sup> Recent empirical research has shown that constitutional endurance is positively associated with societies that have higher per capita GDP, are more democratic, and are more politically stable. *See id.* at 30–32.

<sup>15</sup> *See infra* Part IV.A.

<sup>16</sup> ELKINS ET AL., *supra* note 13, at 78; *see also* Ran Hirschl, *The “Design Sciences” and Constitutional “Success,”* 87 TEX. L. REV. 1339, 1339 (2009) (“[Constitutional design literature] suggests that desirable social and political outcomes may be accomplished through optimal institutional planning and implementation.”).

<sup>17</sup> ELKINS ET AL., *supra* note 13, at 207–08; *see infra* Part IV.B.

<sup>18</sup> *See infra* Part IV.B.1.

<sup>19</sup> *See* ELKINS ET AL., *supra* note 13, at 78, 99–103.

<sup>20</sup> *See infra* Part IV.B.1.

Second, the benefits of inclusion described in the constitutional literature also inure in the business organizational context.<sup>21</sup> Founders with a real voice in the drafting process are more invested in the performance and endurance of the organization.<sup>22</sup> Transparency and inclusion also give the structure legitimacy that an obscured drafting process can undermine.<sup>23</sup>

The final feature shown to correlate with constitutional longevity is specificity.<sup>24</sup> Specificity in this context refers to the number of issues addressed and the detail with which they are addressed.<sup>25</sup> The same reasons that support complexity for constitutional bargainers bolster that design element in the business setting.<sup>26</sup> Parties who have invested the time and resources to deliberately address more of the issues that are likely to arise during the operation of the entity are likely to have more faith in the functioning of the entity.<sup>27</sup> Further, the steeper upfront costs make participants less eager to withdraw from the business.<sup>28</sup>

Part II of this Article sets forth some of the problems prevalent in the current approach to drafting organizational documents as well as the suboptimal business documents developed through this process. Part III details the analogy between

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<sup>21</sup> See *infra* Part IV.B.2.

<sup>22</sup> ELKINS ET AL., *supra* note 13, at 80 (noting that after investing resources in political institutions and seeing a return on that investment, stakeholders develop an increased “familiarity with and attachment to the founding document”).

<sup>23</sup> Angela M. Banks, *Expanding Participation in Constitution Making: Challenges and Opportunities*, 49 WM. & MARY L. REV. 1043, 1046 (2008) (“The normative justifications are rooted in participatory democratic theory, emphasizing the importance of broad participation and deliberation for the creation of a legitimate governance system.”); see also Tom Ginsburg et al., *Does the Process of Constitution-Making Matter?*, 5 ANN. REV. L. & SOC. SCI. 201, 206 (2009) (“Higher levels of participation are presumed to function like supermajority rules, restricting the adoption of undesirable institutions and protecting prospective minorities in the democratic processes that are established. Participation thus legitimates and constrains, substituting inclusive processes for consent to make effective government possible.”); Hirschl, *supra* note 16, at 1339 (“In democratic settings, the purported normative goal of such design may be the enhancement of the political system’s democratic credentials (e.g., participation and representation), the increase of accountability and transparency, and the balancing of the principles of majority rule with the idea that democracy may have more to it than mere adherence to those principles. At the more practical level, such design may aim at enhancing the quality and effectiveness of public policy making and, by extension, supporting political, cultural, and economic development in a given polity.”).

<sup>24</sup> See *infra* Part IV.B.3.

<sup>25</sup> See ELKINS ET AL., *supra* note 13, at 84 (“Specificity refers to the level of detail in the constitution and the scope of topics that the document covers.”); *infra* Part IV.B.3.

<sup>26</sup> See *infra* Part IV.B.3.

<sup>27</sup> See ELKINS ET AL., *supra* note 13, at 87 (noting that parties to an extensive and detailed bargain will seek “to ensure that it is up to date and reflects current political realities”); *infra* Part IV.B.3.

<sup>28</sup> See ELKINS ET AL., *supra* note 13, at 87 (“The greater the investment in a particular constitutional bargain, the less willing parties will be to deviate from it by switching to a new bargain.”); *infra* Part IV.B.3.

constitutional design and business organizational drafting. Part IV describes the role of endurance in the constitutional setting and applies the elements associated with long-lived constitutions to the business organizations context. Part V suggests how various components of organizational drafting derived from constitutional design can inform an attorney's approach to document formulation and incorporate objectives of endurance in a way that mitigates certain shortcomings of the current approach and results in better, more predictable structures.

## II. PERSISTENT SHORTCOMINGS IN PRESENT ORGANIZATIONAL PRACTICE

To support the suggestion that business lawyers should seek alternative guideposts for crafting organizational and transactional documents, this section describes an unsettling pattern in such practices—that oftentimes attorneys draft neither thoughtfully nor deliberately<sup>29</sup>—and it discusses the impact those practices have on various parties. Largely, the planning process and resulting contractual products are deeply flawed and fail to ascertain and reflect the objectives of diverse business clients.<sup>30</sup> Although much of the literature exploring the current defective state of practice focuses on the transactional setting (e.g., asset purchase agreements),<sup>31</sup> the same issues are prevalent in organizational planning and drafting, which, like other transactional work, is predominantly a contract-crafting practice.<sup>32</sup> The focus of this Article is primarily on organizational document design and drafting, but the same principles would be largely applicable to most other aspects of transactional practice.

### A. *Perfunctory Drafting Process*

Heavy reliance on precedent and form documents generated by law firms, trade groups, bar association committees, and others is a reality of modern practice.<sup>33</sup> That reliance reflects the need for attorneys to accommodate short timelines for increasingly complex transactions and to keep costs palatable for clients.<sup>34</sup> There is

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<sup>29</sup> Hill, *supra* note 3, at 61 (focusing on “an overlapping but distinct phenomenon: the persistence of redundancy and the ubiquity of cumbersome, inartful, and sometimes imprecise drafting.”); Barak Richman, *Contracts Meet Henry Ford*, 40 HOFSTRA L. REV. 77, 85 (2011) (“Underlying boilerplate contracts—and underlying the automobile assembly line—is what might be called the efficiency of unthinking mimicry.”).

<sup>30</sup> See generally Preston M. Torbert, *The Crisis Exposed by Pari Passu*, 40 HOFSTRA L. REV. 87, 88 (2011) (arguing that “the legal profession needs to seriously upgrade its attention to contract drafting”).

<sup>31</sup> See, e.g., Hill, *supra* note 3, at 59–62 (complex business contracts); Torbert, *supra* note 30, at 87–89 (business contracts generally).

<sup>32</sup> “An LLC’s operating agreement is a contract among its members . . . .” See Daniel S. Kleinberger, *Direct Versus Derivative and the Law of Limited Liability Companies*, 58 BAYLOR L. REV. 63, 116 (2006).

<sup>33</sup> See Eggleston et al., *supra* note 2, at 113–14.

<sup>34</sup> Cunningham, *supra* note 3, at 315 (2006) (identifying the utility of precedent

simply not enough time to draft complex agreements from scratch, nor would that be an efficient way to practice.<sup>35</sup> Although reliance on precedent documents has the benefit of harnessing wisdom accumulated over a number of years,<sup>36</sup> extreme and dogmatic adherence to their terms is seldom optimal.<sup>37</sup>

Attorneys commonly begin the drafting process by locating a precedent document from a similar transaction in the law firm database and trying to cast the current transaction into the mold of a previous deal.<sup>38</sup> For simpler or more standard arrangements, attorneys may rely on form documents that either leave blank various provisions that should be customized for the particular deal or include alternative standard clauses from which the attorney can select to best suit the present bargain.

Once a template has been used successfully (or at least without known problems), subsequent drafters have little motivation to move away from what worked in a prior situation. Indeed, the risks of using an untested form may not be difficult to justify.<sup>39</sup> For an attorney with limited experience, explaining such deviation is all the more daunting.<sup>40</sup>

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agreements for lawyers needing “to meet the time-sensitive demands of intricate drafting and rigorous interpretation.”).

<sup>35</sup> *Id.* (describing the “tight time pressure” under which corporate lawyers draft agreements).

<sup>36</sup> See MITU GULATI & ROBERT E. SCOTT, *THE THREE AND A HALF MINUTE TRANSACTION: BOILERPLATE AND THE LIMITS OF CONTRACT DESIGN* 33 (2013); see also Hill, *supra* note 3, at 59 (“[L]awyers have come up with a production process by which each lawyer can access the accumulated wisdom of many: the ‘form.’”).

<sup>37</sup> See Andrea J. Boyack, *Sovereign Debt and The Three and a Half Minute Transaction: What Sticky Boilerplate Reveals About Contract Law and Practice*, 35 *WHITTIER L. REV.* 1, 23 (2013) (book review) (“While commoditization may, to some extent, be a welcome cost-saver, mindless boilerplate churning is a distressing development for lawyers as well as clients.” (citation omitted)); Cunningham, *supra* note 3, at 315 (“While useful, [form documents] are only partial solutions for meeting the corporate lawyer’s burden.”).

<sup>38</sup> See Cunningham, *supra* note 3, at 327–28 (“Traditionally, corporate lawyers prepare contracts using precedent forms that address comparable transactions. Special needs typically are met by adding deal-conforming provisions from other precedent contracts. Even when lawyers concoct new language for deal-specific circumstances, they invariably do so with reference to extant forms.”); Richman, *supra* note 29, at 79 (“[C]onstructing a contract rarely begins with the principal—the client—articulating his or her contractual needs; rather, it begins with the accumulated knowledge that the law firm has amassed from its past production experience.”).

<sup>39</sup> Boyack, *supra* note 37, at 12–13 (“ . . . theory [for why certain clauses remain in contracts] holds that standardized contract terms represent the highest evolution of a given type of contract, containing great collective wisdom and time-tested terms. In theory, during the development of these terms, latent ambiguities and defects are weeded out through a process of rejection and refinement, resulting in a near-perfect, and wholly understood written contract form.” (citation omitted)).

<sup>40</sup> See William E. Foster & Emily Grant, *Memorializing the Meal: An Analogical Exercise for Transactional Drafting*, 36 *U. HAW. L. REV.* 403, 407 (2014) (“Recent graduates, having just spent three years in law school and a summer studying intricate bar exam hypotheticals, are daunted by the myriad issues implicated in each provision they draft.



So often, however, in contemporary practice, documents lack context.<sup>41</sup> Transactional and organizational documents are no longer housed exclusively in binders on the shelves with a complete company history and the transactional closing book, but instead in the digital ether of the law firm servers.<sup>42</sup> An attorney can find, with a few search terms, dozens of sample agreements, but the context of those transactions is lost.<sup>43</sup> Even assuming that the document an attorney finds was appropriate for the specific transaction it was negotiated for, it may not be appropriate for present drafting needs.<sup>44</sup> Even more so, that precedent document itself may have been the product of heavy reliance on previously drafted agreements.<sup>45</sup> So a drafter with a precedent contract from the server's stockpile can be multiple steps removed from the purpose and origins of that document, which affects the weight that should be afforded that document as a guide.<sup>46</sup>

In addition to the lost context of electronic document templates, rigid adherence to unfamiliar forms risks unintentional retention and compromises effective agency.<sup>47</sup> Clients may be delighted in part by the use of well-worn precedents in that they simplify the negotiation process and make it less expensive.<sup>48</sup> Attorneys using

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As a result, they get anxious about their drafting responsibilities.” (citation omitted)).

<sup>41</sup> See Cunningham, *supra* note 3, at 327–29 (discussing how precedent documents are generally organized in a “linear rather than modular” format, “appear[ing] as full-length contracts read page-by-page, not clustered by clause type.”).

<sup>42</sup> *Id.* at 315 (“Increasingly, lawyers create and preserve these agreements in electronic forms that enable word searching.”).

<sup>43</sup> *Id.* at 327–29.

<sup>44</sup> See Joshua Stein, *How to Prevent Mistakes in Transactional Legal Work*, PRAC. LAW., Sept. 1994, at 51, 53–54 (“[W]orking from ‘the documents we used in the last deal’ can create problems. This is especially likely when the current transaction involves different parties, different property, and a different business deal. Using the same documents as used in an earlier transaction may burden you with every concession, negotiated omission, and deal-specific variation from the first transaction, in addition to whatever new inconsistencies and imperfections the drafting and negotiating process for the new transaction might create.”).

<sup>45</sup> For example, empirical studies of definitions of Generally Accepted Accounting Principles in corporate contracts “suggest[] that the most fruitful explanations for differences in [such provisions] are path dependence and the habits of traditional form practice that corporate lawyers follow. . . . [V]ariation between contract types most likely is a function of what formulation was used in earliest versions of particular contract types.” Cunningham, *supra* note 3, at 327.

<sup>46</sup> *Id.* (“[S]tylistic path dependence also arises within particular law firms, whose original choice of a given expression of a term can continue despite it being either too simple or unnecessarily complex.”).

<sup>47</sup> See GULATI & SCOTT, *supra* note 36, at 38–39.

<sup>48</sup> See Mark R. Patterson, *Standardization of Standard-Form Contracts: Competition and Contract Implications*, 52 WM. & MARY L. REV. 327, 342–43 (2010) (positing that contract standardization is desirable because it lessens transaction costs and provides a contract “whose meaning and interpretation is more certain.”); Boyack, *supra* note 37, at 21 (“Clients also push contract commoditization by demanding cheaper, faster legal solutions to their business goals.”).

forms can complete a transaction in a compressed timeframe and can avoid accruing hours of seemingly excessive billing time.<sup>49</sup> Moreover, standardized forms represent the successful prior experiences of similarly situated parties.<sup>50</sup>

Reverential dependence on such forms may not, however, reflect the unique circumstances of clients. If standard forms are so pared down in terms of content and flexibility, clients may question the value of involving attorneys in the transaction at all.<sup>51</sup> Alternatively, documents that address every possible contingency in complex detail may be even less useful to a client whose organizational structure and operations are relatively simple.<sup>52</sup> In both run-of-the-mill and highly customized transactions, clients also remain frustrated by lengthy negotiations and by the ultimate contractual product produced from various approaches to form-based practice.<sup>53</sup>

Explanations for why the business drafting process is problematic and for the rampant overreliance on precedent documents are numerous.<sup>54</sup> First, law firms and attorneys lack incentives to undertake the costly and time-consuming process of drafting innovative and unique documents for every transaction.<sup>55</sup> The expense of

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<sup>49</sup> See Kevin E. Davis, *Contracts As Technology*, 88 N.Y.U. L. REV. 83, 90 (2013) (“[T]he costs of creating a contractual document also have to be considered.”); Patterson, *supra* note 48, at 327 (“Standard-form contracts are a common feature of commercial relationships because they offer the advantage of lower transaction costs.”).

<sup>50</sup> Eggleston et al., *supra* note 2, at 112 (“The form contract is attractive because it reflects the accumulated wisdom of parties who have used the contract in the past.”); Patterson, *supra* note 48, at 343.

<sup>51</sup> See Boyack, *supra* note 37, at 23 (“Contracting commoditization not only dissociates transactional practice from the creative and analytic skills prized by generations of lawyers and honed in our law schools, but as a practical matter renders lawyers less valuable and less necessary to contracting.”).

<sup>52</sup> See Claire A. Hill, *Bargaining in the Shadow of the Lawsuit: A Social Norms Theory of Incomplete Contracts*, 34 DEL. J. CORP. L. 191, 191 (2009); Henry E. Smith, *Modularity in Contracts: Boilerplate and Information Flow*, 104 MICH. L. REV. 1175, 1213–14 (2006).

<sup>53</sup> Cunningham, *supra* note 3, at 315 (“Despite [the use of forms to streamline the drafting process], clients often complain that corporate contracting is too protracted and evidence shows that resulting contract terms sometimes are oversimplified or excessively complex. Both problems increase transaction costs associated with these important exchanges.”).

<sup>54</sup> GULATI & SCOTT, *supra* note 36, at 33–43.

<sup>55</sup> *Id.* at 163 (“[D]espite the many caveats, there remains evidence that the institutional structure of the modern large law firm impedes innovation in contract design.”); Davis, *supra* note 49, at 88 (“[L]aw firms have limited incentives to generate innovative contracts for use by others.”).

locating<sup>56</sup> or creating<sup>57</sup> alternative provisions, as well as the cost of assembling and editing unfamiliar language,<sup>58</sup> may steer attorneys toward the ease and safety of extant documents.

The benefits generated by such innovation flow to others outside the firm.<sup>59</sup> The costs involved in generating and refining transactional and organizational documents are borne exclusively by the drafting firm, but the benefits of the innovation flow easily and uncontrollably outside of the firm. Transactional lawyers frequently exchange documents in electronic formats that are easily duplicated, making it exceptionally difficult for attorneys to retain control over the dissemination and replication of their work product. This situation is described as a collective action problem where an individual in a group—for example, one attorney among all drafting attorneys—bears the cost of an action that benefits the other members of the group, who act as free riders.<sup>60</sup> Because of the high costs of innovative drafting with benefits running to unknown parties, “[l]aw firms discourage contract evolution, push transactional volume and conformity, and penalize innovation.”<sup>61</sup>

In addition to avoiding the expenditure of cost and time to deviate from precedents, the use of preexisting documents provides a level of comfort to the drafter, the client, the organization, and the industry as a whole.<sup>62</sup> Attorneys by their

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<sup>56</sup> “[S]earch costs to find superior alternatives may be high and prevent locating them . . . .” Cunningham, *supra* note 3, at 327. In the same sense that it is difficult to divine the motivations for the terms that are contained in the prior contract, it is also expensive to find or create new provisions. *Id.* at 328. “Locating suitable precedent documents can be expensive and involve numerous steps. Search costs are reduced by repositories of precedent documents, including Westlaw, LEXIS, the SEC’s EDGAR system, and University of Missouri’s new Contracting and Organization Research Institute (CORI).” *Id.* Despite this ever-increasing access to quality form documents, it is difficult to justify these costs when the end result may be only marginally better than extant forms. *Cf. id.* at 328–29 (describing the steps required to tailor precedent documents to a specific transaction).

<sup>57</sup> “[S]witching costs may be high to identify alternative ways to capture accumulated wisdom in contract terms . . . .” *Id.* at 327. In other words, a single precedent document contains a great deal of information about prior transactions, both successful and unsuccessful, and other sources of this information are less obvious. *Id.*

<sup>58</sup> *Id.* at 327–28 (discussing how costs associated with composition and review of contracts can be reduced by replicating terms despite issues of “oversimplification or excess complexity” and that “[m]aking changes often entails creating numerous internal cross-references in contracts”); *see also* Boyack, *supra* note 37, at 14 (“Furthermore, once changes are proposed to one part of a form, it opens up the entire document to re-negotiation, which undercuts one of the great utilities of form use to begin with, namely ease of contracting.”).

<sup>59</sup> Davis, *supra* note 49, at 105 (explaining that, although the social benefit of innovative documents may be high due to the low cost to others to copy that work, the producers of innovative documents have “sub-optimal incentives to invest in [such] innovation” because they typically do not share in the benefits derived by those copiers).

<sup>60</sup> GULATI & SCOTT, *supra* note 36, at 40–41.

<sup>61</sup> Boyack, *supra* note 37, at 17.

<sup>62</sup> Patterson, *supra* note 48, at 343 (“[A] contract that is more commonly used is more

nature are generally risk averse, both on behalf of their clients and for themselves, and contract drafting is no exception.<sup>63</sup> Drafters develop a comfort level in using terms that have been used over time, with the added benefit of reducing the risk of erroneous interpretation.<sup>64</sup> In the same sense, a deviation from customary provisions more blatantly leaves lawyers exposed to criticism and to the questioning of their judgment.<sup>65</sup>

Transactional documents—particularly organizational documents—govern real institutions, and modification of the document has an impact in how the organization may be run or how certain things are accounted for in an individual transaction.<sup>66</sup> Additionally, from an industry-wide standpoint, drafters recognize

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commonly interpreted by courts, and therefore is a contract whose meaning and interpretation is more certain. To the extent that a user values this certainty, as most do, the contract is therefore more valuable even for users who are not familiar with its terms.” (citations omitted)).

<sup>63</sup> Edward A. Bernstein, *Law & Economics and the Structure of Value Adding Contracts: A Contract Lawyer’s View of the Law & Economics Literature*, 74 OR. L. REV. 189, 235–36 (1995). Bernstein explains that

[c]ontract lawyers often resist the assumption of risk for any number of reasons other than the best interest of the clients. They may fear losing the client if a remote contingency occurs more than they fear transaction breakdown that can be attributed to opposing counsel, they may not know the client’s circumstances, or they may simply be inexperienced. In any event, it is important to recognize agency problems since it is the decisionmaker’s risk aversion that controls contracting decisions.

*Id.* (citation omitted); *see also* Hill, *supra* note 3, at 67 (noting that most lawyers “will defer too much” to form documents).

<sup>64</sup> GULATI & SCOTT, *supra* note 36, at 34. Learning externalities speaks to the drafter’s own efficiency in using the same document and the same terms. *Id.*

<sup>65</sup> *Id.* at 39–40; *cf.* Scott Baker & Kimberly D. Krawiec, *The Economics of Limited Liability: An Empirical Study of New York Law Firms*, 2005 U. ILL. L. REV. 107, 111 (“[T]he choice of organizational form is a complicated matter, dependant [sic] on a variety of factors, including the behavior of other similarly situated firms that the decision makers consider competitors for prestige and clients.”); Marcel Kahan & Michael Klausner, *Path Dependence in Corporate Contracting: Increasing Returns, Herd Behavior and Cognitive Biases*, 74 WASH. U. L.Q. 347, 356 (1996) (“In many situations, . . . judgments regarding the lawyer’s ability will be less harsh if the contract term that led to the bad outcome was one that many other lawyers had employed in similar circumstances.”); Bruce M. Price, *A Butterfly Flaps Its Wings in Menlo Park: An Organizational Analysis of Increases in Associate Salaries*, 2005 WIS. L. REV. 713, 743 (discussing law firms’ tendency to raise compensation in order to keep pace with competitors and maintain the appearance of professional legitimacy).

<sup>66</sup> GULATI & SCOTT, *supra* note 36, at 38–39; *see also* D. Gordon Smith & Brayden G. King, *Contracts as Organizations*, 51 ARIZ. L. REV. 1, 31 (2009) (“[C]ontracts, through years of experience and adapting, become routine solutions to common problems faced by organizations.”). For example, a modification of a loan-to-value formula in a lending agreement could alter the requirements for how a borrower reports to its lender in a way that

benefits associated with using the same form, structure, and language as other lawyers.<sup>67</sup> When terms are prevalent among a large number of users, unique terms become more idiosyncratic, and the slight benefits of modifying the language to more accurately reflect the deal may be outweighed by the burden of leaving the security associated using the existing form language.<sup>68</sup>

Apart from practical cost and comfort considerations, another explanation for the strict reliance on form or precedent documents is grounded in the status quo bias that parties and drafting attorneys have with respect to preexisting language.<sup>69</sup> Additionally, “anchoring effects may bias them to rely too much upon inherited terms contained in those forms.”<sup>70</sup> In other words, the terms contained in preexisting documents carry more influence than they would absent their inclusion, for whatever reason, in the precedent document.<sup>71</sup> People also tend to place a higher value on retaining what they already have than they would otherwise ascribe to the same thing.<sup>72</sup> In the drafting context, modifying structure or language involves both adopting something new and giving something up, and there is the potential for the sense of loss or risk associated with that deviation.<sup>73</sup>

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is unduly burdensome to the borrower, the lender, or both.

<sup>67</sup> The market uniformity theory “posits that there is value to having identical contractual products in a market, and that standard terms persist because the value of uniformity outweighs the cost of coordinating a move to new contractual language among all users.” Boyack, *supra* note 37, at 13.

<sup>68</sup> GULATI & SCOTT, *supra* note 36, at 34–35; *see also* Joshua Stein, *Cures for the (Sometimes) Needless Complexity of Real Estate Documents*, REAL EST. REV., Fall 1995, at 63, 66, available at <http://www.joshuastein.com/infoFrame.php?pdf=26>, archived at <http://perma.cc/9ZLG-ALZE> (“The unease about the growing complexity of transactions rarely translates into specific steps to simplify them. Because transactions have always been negotiated and closed this way, individual participants in particular transactions hesitate to do anything differently. They accept these cumbersome processes because they assume the other side is playing the same game.”).

<sup>69</sup> *See* Russell Korobkin, *The Status Quo Bias and Contract Default Rules*, 83 CORNELL L. REV. 608, 625 (1998) (“[S]tatus quo bias[] is that people systematically favor maintaining a state of affairs that they perceive as being the status quo rather than switching to an alternative state, all else being equal.”); *see also* Kahan & Klausner, *supra* note 65, at 361–62 (discussing the effects of status quo bias as it relates to standard corporate contract terms).

<sup>70</sup> Cunningham, *supra* note 3, at 327. “‘Anchoring’ refers to the ability of initial ‘reference points’ to influence judgments. Once initial reference points, or ‘anchors,’ are established, adjustments to these initial anchors tend to be too small. Anchoring thus biases final judgments in the direction of the anchor.” Kahan & Klausner, *supra* note 65, at 362.

<sup>71</sup> Kahan & Klausner, *supra* note 65, at 363 (“Standard terms carry an aura of stability and objectivity . . . . Although the presence of learning and network externalities may provide a rational reason for a firm to adopt a standard term, the possibility of anchoring bias suggests that a decision to adopt such a term may not be wholly rational or value-enhancing.”).

<sup>72</sup> This is known as the endowment effect. *See* GULATI & SCOTT, *supra* note 36, at 41–42 (citing Russell Korobkin, *Behavioral Economics, Contract Formation, and Contract Law*, in BEHAVIORAL LAW AND ECONOMICS 116 (Cass R. Sunstein ed., 2000)).

<sup>73</sup> *See* Korobkin, *supra* note 69, at 655–56 (arguing that contracting parties may be significantly more concerned with losing rights rather than gaining others and this

Finally, departures from form or precedent documents can be an inadvertent, often negative, signal to other parties or attorneys about the goals and intentions of the drafter and the drafter's client.<sup>74</sup> Requesting a change in boilerplate language or in a frequently used industry term can raise concerns about the trustworthiness and commitment of a party<sup>75</sup> or may unnecessarily characterize the client's position as unique or troublesome.<sup>76</sup> Attorneys may also be reluctant to change something because changing the term in future documents makes it seem like the past documents meant something else (i.e., that the revision was a subsequent remedial measure).<sup>77</sup> A simple modification of a boilerplate term, perhaps even intended to clarify the writing, may erroneously signal that the previously used term meant something different.<sup>78</sup>

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phenomenon may better explain adherence to the status quo in contract drafting).

<sup>74</sup> See Omri Ben-Shahar & John A.E. Pottow, *On the Stickiness of Default Rules*, 33 FLA. ST. U. L. REV. 651, 652 (2006) (“[I]n the presence of a familiar and commonly utilized background provision . . . a transactor might fear that proposing an opt-out from th[is] default will dissuade his potential counterparty from entering into the agreement. The fear is that the counterparty will suspect that the proposer’s decision to deviate from the norm and use an unfamiliar provision hides some unknown problem: in short, that it is a ‘trick.’”); Boyack, *supra* note 37, at 14 (discussing the theory that “making any change to form language signals a novel risk to the counterparty and/or will invite costly additional negotiation.”).

<sup>75</sup> GULATI & SCOTT, *supra* note 36, at 35–37; see also Ben-Shahar & Pottow, *supra* note 74, at 652–53 (describing how transactors and counterparties may react to proposed modifications of boilerplate forms).

<sup>76</sup> See George W. Dent, Jr., *Business Lawyers as Enterprise Architects*, 64 BUS. LAW. 279, 311 (2009) (“The effects of novel terms are hard to predict; business people feel more comfortable with customary terms. They also prefer to rely on trust and cooperation rather than on contract terms. Proposing novel or complex terms may signal that a party intends to ‘rely on his legal rights’ in case of a dispute rather than trying to resolve it amicably.” (citations omitted) (quoting Lisa Bernstein, *Social Norms and Default Rules Analysis*, 3 S. CAL. INTERDISC. L.J. 59, 70 (1993))).

<sup>77</sup> “Boilerplate that has repeatedly been construed by courts will take on a set, common meaning, but one that may not be easily understood by reading the language itself.” Michelle E. Boardman, *Contra Proferentem: The Allure of Ambiguous Boilerplate*, 104 MICH. L. REV. 1105, 1111 (2006); see also GULATI & SCOTT, *supra* note 36, at 37.

<sup>78</sup> See Boyack, *supra* note 37, at 14 (discussing this concept as “hindsight bias theory”). For example, a party may want to add the following anti-assignment provision to a contract:

Neither this Agreement, nor any of the rights, obligations and duties hereunder, may be assigned by either party without the prior written consent of the other party.

Inclusion of this anti-assignment provision in a contract that previously had none might signal that the prior contracts were intended to be assignable. More specifically, the language could be revised in a later document to say that the agreement may not “be assigned or otherwise transferred by either party.” The addition of “or otherwise transferred” in a subsequent document may not have been intended by the party to be a departure of its understanding of the effect of the previous agreements that lacked such language.

Ultimately, these theories seek to explain the difficulty for attorneys to stray even slightly from boilerplate contract language and precedent structures. However the motivations that give rise to current practice are labeled, collectively, they describe an environment in which it is challenging or risky to be innovative. At the end of the day, attorneys are frazzled in practice and it requires a great deal of effort to reinvent the wheel. Particularly for junior lawyers, there is security in documents that are tried and true. Simply stated, on some level, attorneys are seemingly incapable or unwilling to spend the time to change their documents or routines. Acknowledging that reality is helpful in evaluating when and whether to suggest changes to prevailing drafting processes.

### B. *Prêt-à-Porter Agreements*

Overreliance on form or precedent documents is problematic for the drafting attorney, the client, the unsophisticated and underrepresented investors, and thus ultimately the business as a whole. First, sheer form practice is less fulfilling from a professional standpoint for lawyers themselves.<sup>79</sup> From a business reputation perspective, overreliance on forms cheapens the skill and services that lawyers provide and in turn creates dissatisfaction among clients, who expect attorneys to be more than scriveners.<sup>80</sup> Instead, lawyers should be “creative, flexible, dynamic problem solvers,”<sup>81</sup> adding unique value to the document for the client.<sup>82</sup>

Second, organizational documents laced with carryover language from a prior agreement may not reflect the true intentions of the parties to the current transaction.<sup>83</sup> Documents that are not thoughtfully created or at least modified for the unique transaction at hand can expose a client to risks of liability, a failed business deal, or loss of capital or goodwill.<sup>84</sup> At the very least, those documents could fail to reflect any customization for the client or include any specifics about the particular business.<sup>85</sup> Cut-and-paste documents are also not user-friendly; they

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<sup>79</sup> *Id.* at 23 (noting that “transactional practice focused on producing assembly-line contracts is far less fulfilling for the practitioner.”).

<sup>80</sup> *Id.* at 1–2 (“Clients complain that the benefit received from their transactional counsel do not justify the cost, particularly when lawyers revert to the role of mere scrivener and mindlessly rely on contractual boilerplate.”).

<sup>81</sup> *Id.* at 22.

<sup>82</sup> *Id.* (“In today’s tighter and more cynical legal market, it is vital that lawyers at every level add sufficient value to a transaction to justify their salary and employ. Transactional legal practice must focus on adding true value as an *ex ante* advocate, and that involves contract research and design, not just mechanical contract production.” (citation omitted)).

<sup>83</sup> *Id.* at 21.

<sup>84</sup> *Id.* (“The divorce of intent from contract boilerplate causes a divorce of reality from the law and unjustifiably creates or perpetuates avoidable client risks.”).

<sup>85</sup> See Bernstein, *supra* note 63, at 232 (“The substance of standardized provisions and default rules of law, like store-bought clothes, often do not fit the situation precisely and may not maximize the value of the transaction to the parties.”).

are often laced with jargon, stylized language, and unnecessarily complex terms.<sup>86</sup> For example, many long and complicated provisions in an LLC agreement provide nothing more than the statutory language, which would be the default outcome in the absence of a contradictory contract term.<sup>87</sup> Indeed, the modern drafting process accommodates hoarding of complex terms into singular documents that at an extreme are unreadable and useless.<sup>88</sup>

In addition to the problems it creates for the drafting attorney's client, whichever investor or group of investors that may be, thoughtless drafting that relies too heavily on form or precedent documents can exacerbate the problem of information asymmetry and can leave the interests of certain investors underrepresented.<sup>89</sup> In general, the regulation of publicly held companies places great emphasis on parity of information, at least in regard to the business operations, goals, and prospects.<sup>90</sup> For example, corporations with securities traded on national exchanges face extensive and frequent securities disclosures that facilitate the efficient movement of capital in markets.<sup>91</sup> In privately held companies, however, information asymmetry is less of a concern and certainly less of a legal concern in

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<sup>86</sup> Cunningham, *supra* note 3, at 315 (“[C]orporate lawyers traditionally engage in elaborate contracting processes and struggle to draft agreements using stylized language in contracts of growing density, often containing hundreds of terms.”).

<sup>87</sup> See Bernstein, *supra* note 63, at 232 (“When drafting a contract, a lawyer must decide when to use default rules of law, standardized provisions, or provisions specifically tailored to meet the needs of the client. If he selects a tailored provision, he must choose between state-contingent precision or general, goal oriented language. Selecting the appropriate option usually involves balancing negotiation costs against the increase in value that will be achieved if they are incurred.”); Sandra K. Miller et al., *An Empirical Glimpse into Limited Liability Companies: Assessing the Need to Protect Minority Investors*, 43 AM. BUS. L.J. 609, 621–22 (2006) (describing the dynamic between LLC agreements and statutory defaults).

<sup>88</sup> Cunningham, *supra* note 3, at 325 (“[A]necdotal evidence suggests that corporate contracting processes can be too complex and empirical evidence shows that resulting contract terms are prone to both oversimplification and excess complexity.”). Additionally, “[t]echnology is yet another cause of the ever-increasing complexity of legal documents. . . . Because endless additions, changes, and improvements are possible [due to modern word processing software], they become expected, and, eventually, inevitable.” Stein, *supra* note 68, at 65. As the process of structuring and assembling documents becomes more automated, greater complexity will become easier than ever to achieve, hence inevitable. *Id.*

<sup>89</sup> See Davis, *supra* note 49, at 97 (describing how better informed parties can leverage the asymmetry of information for more favorable terms).

<sup>90</sup> Stephen J. Choi & Andrew T. Guzman, *Portable Reciprocity: Rethinking the International Reach of Securities Regulation*, 71 S. CAL. L. REV. 903, 941–42 (1998) (“One of the most cited and intuitive goals of the securities laws is the protection of investors. . . . Underlying the notion of investor protection is the assumption that investors are unable to protect themselves. Investors may lack the resources to request information from issuers and analyze this information on their own.” (citation omitted)).

<sup>91</sup> See 15 U.S.C. § 78m (2012) (identifying reporting requirements of registered publicly held companies).



terms of regulations and disclosures.<sup>92</sup> One of the primary advantages of privately held companies is that they do not have the same public disclosure requirements that are so costly for public companies to maintain.<sup>93</sup> But that efficiency and privacy can come at a cost to the transparency of the organization and the liquidity of the investment.<sup>94</sup> The imbalance of information can be problematic when privately held companies fail to address and incorporate the interests of the limited pool of investors, which can lead to unclear expectations and unfortunate business failures.<sup>95</sup>

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<sup>92</sup> See Elizabeth Pollman, *Information Issues on Wall Street 2.0*, 161 U. PA. L. REV. 179, 207 (2012) (discussing the variations in publicly available information for private companies).

<sup>93</sup> See Beverley Earle & Gerald A. Madek, *The New World of Risk for Corporate Attorneys and Their Boards Post-Sarbanes-Oxley: An Assessment of Impact and a Prescription for Action*, 2 BERKELEY BUS. L.J. 185, 218–22 (2005) (discussing several accounts of the financial costs of sustaining public company status in the face of increasing regulatory requirements).

<sup>94</sup> See Robert Reilly & Aaron Rotkowsky, *The Discount for Lack of Marketability: Update on Current Studies and Analysis of Current Controversies*, 61 TAX LAW. 241, 241–42 (2007) (“[T]he security of a closely held company is not as liquid as an otherwise comparable security of a publicly traded company. That is, a closely held company security does not have the same degree of marketability as an otherwise comparable publicly traded security.”).

<sup>95</sup> Pollman, *supra* note 92, at 210 (“Thus, the bottom line is that market participants may have little to no information of the type typically considered necessary for accurate pricing. Varying amounts of other information may be available, but it may be inaccurate and misleading.”); see Larry E. Ribstein, *The Uncorporation’s Domain*, 55 VILL. L. REV. 125, 133–34 (2010) (noting that “partnership default rules enabling owners to cash out of or force liquidation of the firm can invite opportunistic conduct by individual members and possible loss of going concern value.”).

A stereotypical privately held company may have a money person, a property person, and a service (or sweat equity) person.<sup>96</sup> Inevitably, one party to the transaction, arguably the money person, will be more sophisticated in dealing with business investments and organizational creation.<sup>97</sup> This person will more likely be familiar with the documents and the legal choices involved in establishing a business.<sup>98</sup> The service person, on the other hand, may understand the nature of the unique business being formed—the industry practices and the practical needs for day-to-day operations—but be less aware of the legal aspects of creating the company.<sup>99</sup>

All investors are faced with complex organizational documents for even the simplest partnerships—documents that are difficult enough to absorb and process for a legally sophisticated client, let alone someone without any special legal knowledge.<sup>100</sup> Poorly drafted and nearly incomprehensible organizational documents exacerbate the disparity of sophistication levels among the investors.<sup>101</sup>

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<sup>96</sup> *But see* *Stafford v. United States*, 611 F.2d 990, 995 (5th Cir. 1980) (noting that the classification of contributions into “property” and “services” is not always entirely clear and can have varying tax consequences).

<sup>97</sup> For example, “[t]he LLC serves a broad constituency of businesses varying widely in sophistication, financial stature, and legal representation.” Sandra K. Miller, *What Fiduciary Duties Should Apply to the LLC Manager After More Than a Decade of Experimentation?*, 32 J. CORP. L. 565, 586 (2007).

<sup>98</sup> *See* Sandra K. Miller, *Legal Realism, the LLC, and a Balanced Approach to the Implied Covenant of Good Faith and Fair Dealing*, 45 WAKE FOREST L. REV. 729, 740 (2010) (“[S]tudies suggest that controlling and minority investors may not be equally represented by counsel. They may not be actively bargaining for optimal protections.”).

<sup>99</sup> *See, e.g.*, Frances S. Fendler, *A License to Lie, Cheat, and Steal? Restriction or Elimination of Fiduciary Duties in Arkansas Limited Liability Companies*, 60 ARK. L. REV. 643, 643–44 (2007) (“The vast majority of these LLCs appear to be small businesses, and many if not most of them are probably formed by persons relatively unsophisticated about the legal rules which govern the operation of LLCs.” (citation omitted)).

<sup>100</sup> *See* Sandra K. Miller, *A New Direction for LLC Research in a Contractarian Legal Environment*, 76 S. CAL. L. REV. 351, 407 (2003). For example:

The LLC member without counsel is unlikely to comprehend the significance of an arbitration clause or a right to remove an LLC member or manager. He or she may not have the foresight to include a provision regarding the method of valuation and the terms and conditions of an appraisal. The LLC member without counsel may pay little attention to profit-sharing ratios, rights to compete, or choice-of-law clauses. Such an investor may understand little about the significance of omitting a buy-out clause upon voluntary or involuntary dissociation. The benefits of favorable tax treatment and a simplified managerial structure may well pale in comparison to the serious financial losses that can result from an unfavorable LLC agreement signed hastily and without the benefit of legal counsel.

*Id.*

<sup>101</sup> *Davis, supra* note 49, at 98 (discussing the impact of uncertainty on client

Adding to the information disparity is the general approach of organizational documents to value capital contributions above other types of contributions. For example, the business documents will specify the circumstances under which investors may be required to contribute additional money to the entity and the consequences of their failure or inability to do so. Can the services investor, who typically lacks the financial resources of the money investor, be absorbed by the others who can afford to make additional contributions? Does that investor know and appreciate the ramifications of those contract provisions at the outset of the bargain? The answer may depend on whether that investor was independently represented and how thorough the negotiations and drafting processes were.

More obvious bargaining power discrepancies and incentives are involved when the ownership interests of the members are unequal.<sup>102</sup> Empirical evidence suggests that in fact very little negotiation takes place with respect to these and other issues, particularly by minority interest holders.<sup>103</sup>

Certainly the market process can help to alleviate some of the information disparity. Each of the investors can hire an attorney to help protect their interests and negotiate to make the organizational documents as beneficial to themselves as possible. But again, separate representation typically means that the member contributing cash or the majority member—who can better afford legal representation, has the sophistication to understand the implications, and knows enough to push for various concessions—is the member who will most often dictate the terms of the agreement.<sup>104</sup> In the abstract, society can accept this result because it values the mobility of capital and because the services investor will have a countervailing advantage to the extent that the services (or the real estate from the property investor) have unique value to the operation.<sup>105</sup> Even when the services or

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expectations and understanding).

<sup>102</sup> See Michael K. Molitor, *Eat Your Vegetables (or at Least Understand Why You Should): Can Better Warning and Education of Prospective Minority Owners Reduce Oppression in Closely Held Businesses?*, 14 *FORDHAM J. CORP. & FIN. L.* 491, 563–64 (2009); see also Miller, *supra* note 100, at 408 (“[M]inority investors frequently lack the bargaining power and/or the wherewithal to obtain effective express contractual protection from illegal, fraudulent, or fundamentally unfair majority conduct.”).

<sup>103</sup> See Miller, *supra* note 100, at 357 (finding that of 770 practitioners surveyed in California, Delaware, New York, and Pennsylvania, “[o]ver two-thirds . . . believed that many LLC agreements are based on form agreements that are not extensively negotiated.”); see also Molitor, *supra* note 102, at 563–64 (noting that among many factors commonly addressed as reasons for the failure of minority shareholders to adequately protect their investments is their lack of sophistication and the incompetency of their counsel).

<sup>104</sup> Lawrence E. Mitchell, *Professional Responsibility and the Close Corporation: Toward a Realistic Ethic*, 74 *CORNELL L. REV.* 466, 505 (1989) (describing some founders as “creative or scientific types who may previously have worked in business but who are not likely to be skilled or experienced in financial and legal matters.”); see also Miller, *supra* note 100, at 398 (discussing the “not-so-level playing field for majority and minority” contributors).

<sup>105</sup> “The benefits of greater capital mobility are broadly acknowledged among economists, though less so than the benefits of trade, even among trade’s most ardent

property person has the most bargaining power, they still often lack the business sophistication to leverage that bargaining power.<sup>106</sup> Capital investors typically are more familiar with the process and know how to use legal counsel to represent their interests at formation.<sup>107</sup>

Query whether this disparity and the corresponding underrepresentation of minority and non-cash investors is a concern or responsibility of drafting attorneys. Clearly not always and not entirely,<sup>108</sup> but to the extent that attorneys are facilitating transactions between individuals with a common goal and vision, it behooves everyone for attorneys to clarify the options with respect to legal rights, obligations, and duties, thereby enhancing the business's likelihood of success.<sup>109</sup> To that end, it

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defenders.” See Jason Bordoff & Jason Furman, *Progressive Tax Reform in the Era of Globalization: Building Consensus for More Broadly Shared Prosperity*, 2 HARV. L. & POL’Y REV. 327, 342 n.54 (2008).

<sup>106</sup> Miller, *supra* note 100, at 398; see also Molitor, *supra* note 102, at 563–64 (citing minority participants’ failure to anticipate unfair treatment by the majority, their overzealous optimism, and their reluctance to discuss difficult issues during formation for fear of damaging their relationship of trust with the majority as common reasons for minority owners’ lack of initial planning in new business ventures).

<sup>107</sup> See Miller, *supra* note 100, at 354–58 (reporting that respondents from a survey of business attorneys in four states tended to represent majority LLC owners, with 56% reporting they had represented majority owners while only 20% had represented minority owners).

The low overall rate of usage of contractual minority protections tends to paint a portrait of a not-so-level playing field for majority and minority participants. Legal counsel for minority investors may be unaware of the value of enacting express contractual protections against majority misconduct, or may otherwise be unable to effectively negotiate for the inclusion of such protections in the operating agreement.

*Id.* at 398.

<sup>108</sup> See, e.g., Mitchell, *supra* note 104, at 503 (“In the case of unequal ownership, at points of conflict counsel is obligated to advise the majority that it must deal fairly with the minority, and counsel may even be expected by the minority to represent their interests.”); Nancy J. Moore, *Expanding Duties of Attorneys to “Non-Clients”: Reconceptualizing the Attorney-Client Relationship in Entity Representation and Other Inherently Ambiguous Situations*, 45 S.C. L. REV. 659, 664–65 (1994) (explaining that “the law looks primarily to the actual intentions of the parties, whether express or implied[, to determine the existence of an attorney-client relationship]. Unfortunately, all too often the parties have not thought about the matter in precisely those terms, and yet the ‘clients’ may have relied on the attorneys to protect their interests in the transaction or proceeding. This reliance is particularly notable in cases involving entity-constituent relations, in which lay individuals typically do not view the entity in the same abstract manner as do lawyers. Thus, in the entity context, individual constituents frequently rely on the entity lawyer to protect their interests.” (citation omitted)).

<sup>109</sup> Cf. Moore, *supra* note 108, at 664 (“Multiple representation is permitted because it is sometimes in the best interests of the clients to risk the inherent dangers of multiple

is equally important to recognize the potential for the attorney's role to exacerbate, or at least be complacent in, information disparity and underrepresentation, which can thwart a transaction.<sup>110</sup>

More thoughtful drafting can assist in overcoming problems associated with information disparities and take into account interests of all investors in a way that promotes long-term stability. Structuring and drafting organizational agreements in a more accessible manner gives voice to non-money contributors and minority interest holders and thus strengthens the enterprise as a whole.

### III. CONSTITUTIONS AND ORGANIZATIONAL GOVERNING DOCUMENTS: MAKING THE ANALOGY

Scholars have long analogized between business entities and political bodies.<sup>111</sup> The vast majority of this scholarship has focused on the corporate form, with its clear delineation between managerial authority and ownership.<sup>112</sup> The parallels between the corporation and the state are clear. The shareholders of the corporation are equivalent to democratic citizens who carry the right to vote.<sup>113</sup> These corporate

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representation to achieve a significant benefit in the form of either cheaper and more efficient representation or an enhanced ability to resolve minor differences and reach a shared goal.”).

<sup>110</sup> Molitor, *supra* note 102, at 496 (“While normally [protecting the interest of business owners during entity formation] is a function that attorneys should perform, the sad fact is that this does not appear to be happening with an acceptable frequency, as demonstrated by the never-ending litigation involving minority owner abuse.”).

<sup>111</sup> See, e.g., Colleen A. Dunlavy, *Social Conceptions of the Corporation: Insights from the History of Shareholder Voting Rights*, 63 WASH. & LEE L. REV. 1347, 1351 (2006) (“As an economic institution, a corporation is also necessarily a political institution, for it is peopled by individuals—shareholders, managers, employees—whose relations are structured by the particular distributions of power that have come to characterize the enterprise.”); Laurent Sacharoff, *Former Presidents and Executive Privilege*, 88 TEX. L. REV. 301, 340 (2009) (“[C]orporation law in the United States treats corporations as ‘representative democrac[ies]’ in which shareholders do not directly control decisions but may vote in new management when they desire a change.” (quoting Lucian Arye Bebchuk, *The Case for Increasing Shareholder Power*, 118 HARV. L. REV. 833, 837 (2005) ).

<sup>112</sup> Lucian Arye Bebchuk, *The Case for Increasing Shareholder Power*, 118 HARV. L. REV. 833, 837 (2005) (“The U.S. corporation can be regarded as a ‘representative democracy’ in which the members of the polity can act only through their representatives and never directly.”); Dunlavy, *supra* note 111, at 1353 (“In elections that . . . resembled those of ‘representatives to Congress and to all similar legislative bodies,’ shareholders selected representatives (directors) to sit in a representative assembly (the board of directors) to which the corporation’s constitution ascribed certain powers.” (quoting *Brothers Under Their Skins*, WALL ST. J., Dec. 18, 1937, at 4)); Terry M. Moe, *The New Economics of Organization*, 28 AM. J. POL. SCI. 739, 753 (1984) (“[T]he stockholder-manager relation is but a special case of the more general relation between those who have a ‘right’ to control an organization (ordinarily, residual risk-bearers) and those decision makers (managers) who in fact make most of the important organizational decisions.”).

<sup>113</sup> Michael J. Duffy, *Shareholder Democracy or Shareholder Plutocracy? Corporate Governance and the Plight of Small Shareholders*, 25 U. NEW S. WALES L.J. 434, 438 (2002)

citizens elect directors to the board in the same way voters elect representatives to legislative bodies.<sup>114</sup> However, the analogy is ultimately limited because investments in corporations are voluntary and liquid, and there are substantive differences in the voting rights of each constituency.<sup>115</sup> Nonetheless, the parallels can inform our understanding of the different structures.

Instead of corporations, this Article focuses on private unincorporated business organizations, primarily in various forms of partnerships and limited liability companies—the most popular entities in terms of sheer quantity of formations.<sup>116</sup> The resemblance of these private business organizations to government entities is not quite as apparent as in the corporate realm, but the comparison yields rich analogies.

LLCs and other unincorporated business organizations behave in many ways like corporations, but the structures essentially merge the management and ownership functions.<sup>117</sup> In a corporate board of directors, a one-ninth vote by one of the directors does not correlate to that director's ownership interest in the corporation. On the other hand, a shareholder carries a vote proportionate to his ownership interest, but has no authority to act on behalf of the corporation on a day-to-day basis.<sup>118</sup> In contrast, in an LLC, the equity holders (i.e., the members) typically manage the company, act on behalf of the company, and set company

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(“There are observable parallels between the corporation and the state. For example, in the democratic state the members are citizens carrying the right to vote, whilst in the corporation the members are shareholders.”).

<sup>114</sup> *Id.* at 438.

<sup>115</sup> Usha Rodrigues, *The Seductive Comparison of Shareholder and Civic Democracy*, 63 WASH. & LEE L. REV. 1389, 1389–90 (2006) (“[C]omparisons between the [public] corporate and civic polities, while intellectually tempting, ultimately falter because participation in a corporation fundamentally differs from participation in a nation. Shareholders are not citizens; their investments are voluntary and relatively liquid, and their proxy ballots lack the meaning and power of citizens’ votes.”); *see also* Duffy, *supra* note 113, at 438–42 (noting significant ways in which corporate governance and civic governance differ, including that voting power is not typically equal among shareholders in a corporation as it is for most citizens of a democratic nation). Additionally, a corporation’s “constituency” is continually shifting due to the high trading volume of most public companies, leading to a “divergence between ownership and control” of the company and placing “heightened importance” on the availability of information about the company. *Id.* at 441.

<sup>116</sup> *See* Molitor, *supra* note 102, at 501 (noting that “every state has an LLC statute and the LLC is viewed by many as the ‘entity of choice’ for small businesses.” (citation omitted)); *see also* Miller, *supra* note 100, at 385 (noting that studies have recognized the “growing popularity” of the LLC); Ribstein, *supra* note 95, at 127 (positing that “unincorporate business forms are likely to become more important for a wide variety of firms”).

<sup>117</sup> Moore, *supra* note 108, at 678 (“[U]nlike the publicly held corporation, the ownership and management [of closely held corporations and small partnerships] are substantially identical.”).

<sup>118</sup> *See, e.g.*, DEL. CODE ANN. tit. 8 § 141 (2015); 12 U.S.C. § 61 (2012) (“In all elections of directors, each shareholder shall have the right to vote the number of shares owned by him for as many persons as there are directors to be elected . . .”).

policy.<sup>119</sup> Thus the analogy to a representative government, where a group of people is chosen to act on behalf of the others, seems slightly weaker for an LLC, especially a member-managed LLC, than for a corporation.

Fundamentally, investors in any entity differ from citizens of a national government. Regardless of their economic contribution (through taxes or otherwise) or service commitment to the nation, each citizen usually gets roughly equal representation in national affairs in most democratic institutions.<sup>120</sup> Although there is variance in indirect representation models like the U.S. Senate, generally speaking each citizen gets equal representation and an equal vote in national referenda.<sup>121</sup> In contrast, investors in business enterprises can contribute different amounts of capital, which typically results in different levels of influence and control on the entity's operations.<sup>122</sup> Although on a per-unit or per-share basis, the representation is usually equal, the bottom line is that some members have more say than others (and most would say rightfully so).<sup>123</sup> These distinctions are important in considering the mechanics for adjustments to the organizational document and the impact on the bargain.

Further, unlike contractual agreements enforced by courts, successful constitutions are generally self-enforcing so that it is in the best interest of all factions to abide by the terms of the document.<sup>124</sup> A constitution can be seen as a delicate equilibrium—to be effective, no entity with the power to defect should have enough incentive to do so.<sup>125</sup> Functionally, constitutions define violations of government power—they specifically delineate when a government has overstepped its bounds, so that all citizens are aware and will recognize the power and utility of coordination to enforce the document.<sup>126</sup> This dynamic in turn makes it less likely

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<sup>119</sup> See Robert R. Keatinge et al., *The Limited Liability Company: A Study of the Emerging Entity*, 47 BUS. LAW. 375, 385 (1992) (“Most of the LLC statutes provide for management directly by the members, although the statutes permit the parties to provide, by agreement, for centralized management.”).

<sup>120</sup> Duffy, *supra* note 113, at 438.

<sup>121</sup> Lynn A. Baker & Samuel H. Dinkin, *The Senate: An Institution Whose Time Has Gone?*, 13 J.L. & POL. 21, 22 (1997) (discussing “[t]he right of a citizen to equal representation and to have his vote weighted equally with those of all other citizens’ in both houses of a bicameral legislature.” (quoting *Reynolds v. Sims*, 377 U.S. 533, 576 (1964))).

<sup>122</sup> Keatinge et al., *supra* note 119, at 385 (“The standard statutory terms (which generally may be waived by the members) provide that the members’ rights to participate in profits, distributions and governance will be allocated according to financial contributions and withdrawals, rather than equally as in general partnerships.”).

<sup>123</sup> See *id.* at 414 (“The [LLC] statutes generally direct that the members’ voting rights will be in proportion to their interests in the LLC’s profits.”).

<sup>124</sup> ELKINS ET AL., *supra* note 13, at 7 (“A constitution will be maintained only if it makes sense to those who live under its dictates, so a crucial quality of any successful constitution is that it be self-enforcing.”).

<sup>125</sup> See *id.* at 76–78 (noting that “when those who would breach recognize that their breach will be met with coordinated resistance, they restrain themselves from acting in the first place.”).

<sup>126</sup> Richard Albert, *The Cult of Constitutionalism*, 39 FLA. ST. U. L. REV. 373, 390

that the government will overstep its authority in the first place, which makes the document more self-enforcing.<sup>127</sup>

But LLCs and other private unincorporated business enterprises are largely creatures of contract law.<sup>128</sup> Like corporations, they are voluntary structures where participants agree to contribute to the organization and cede control over such contributions—cash, property, labor—to the group for the efficient functioning of the entity.<sup>129</sup> At the end of the day, a private business enterprise is an agreement by its constituent parties to tie their fates together, to cede authority and control over their resources to the others, and to participate in a larger enterprise. In the business enterprise, the primary common objective of the arrangement is generating a profit for its owners as opposed to the numerous other considerations that may be in play in establishing a government.

Although LLC structures are distinct from representative governments in important ways, the documents governing each structure overlap to a large extent. In fact, at the time when the entity is first formed—whether LLC, corporation, or government<sup>130</sup>—the analogy is the strongest. The founders of a state or the owners of an organization negotiate the terms by which they will agree to work together and pursue mutual interests. Without any previous obligations to each other or rights with respect to each other, participants undertake a mutual commitment and design the terms by which that relationship will operate, defining the rights, duties, and obligations of the parties and the organization. In this way, a constitution and an operating agreement serve similar functions. Among their functions, constitutions

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(2012) (“All constitutions do three things. First, constitutions separate powers by creating an internal structure of authority that serves as a referent for disputes. Second, constitutions identify or create a class of constituents who must govern themselves according to it. Third, constitutions embrace a purpose or a mission that guides constituents and their governors in the conduct of their affairs, both internal to the group and external toward the wider world.”); *see also* ELKINS ET AL., *supra* note 13, at 77 (emphasizing that “the shared expectations and common knowledge are central to constitutional enforcement.” (citation omitted)).

<sup>127</sup> Ginsburg et al., *supra* note 23, at 216 (“Constitutions help resolve . . . coordination problem[s] by generating common knowledge about the scope of acceptable government behavior and by providing a focal point for citizens to organize enforcement efforts.” (citation omitted)).

<sup>128</sup> 1 NICHOLAS G. KARAMBELAS, LIMITED LIABILITY COMPANIES: LAW, PRACTICE & FORMS § 6:14 (2d ed. 2014) (“An operating agreement is contractual in nature and binds the members of the LLC as it is written.”); *see also* Larry E. Ribstein, *The Uncorporation and Corporate Indeterminacy*, 2009 U. ILL. L. REV. 131, 133 (“Uncorporate business forms [LPs, LLCs] rely on specific contractual devices to provide incentives and managerial discipline, reducing their need to rely on monitoring devices such as owner voting, independent directors, fiduciary duties, and derivative litigation. The parties, therefore, can tailor their contracts to their needs, and courts do not need to develop fiduciary rules to deal with a multitude of situations.” (citation omitted)).

<sup>129</sup> Keatinge et al., *supra* note 119, at 412.

<sup>130</sup> Dunlavy, *supra* note 111, at 1352 (“A first step in conceptualizing relations among shareholders is to note that every corporation, every ‘body politic,’ has a constitutional structure, spelled out in statute law and in the company’s bylaws.”).



limit the behavior of government, defining the nation, its aspirations, and its patterns of authority, and establishing necessary institutions.<sup>131</sup> Similarly, the operating agreement is the source document that sets forth the purpose and authority of the organization and defines the rights and obligations of the members of the entity.<sup>132</sup>

Thus, approaches to constitutional design can enlighten drafting of organizational documents that govern business relationships. Even short of a perfect analogy, lessons learned from constitutional drafting can inform our approach to business organizational drafting.

#### IV. ENDURANCE

Part II above details the need to approach organizational document drafting from a different, more deliberate perspective. The pervasiveness of perfunctory consultation and unwieldy work products speaks to the need to look to a variety of sources for design considerations. Though business and transactional attorneys could refine and improve their drafting process and the resulting product in any number of ways,<sup>133</sup> this Article advocates looking to constitutional design literature for a deliberate and thoughtful drafting approach. Constitutional design focuses on endurance<sup>134</sup> and although stakeholders in a newly formed entity often have widely divergent expectations with respect to the length of their commitment, endurance can be a guiding objective for business drafters in many situations because it can facilitate a more thoughtful, collaborative drafting process resulting in documents that are more reflective of unique client objectives.

In constitutional design literature, endurance is a consistently espoused objective for drafters of constitutions.<sup>135</sup> Recent empirical research has shown that constitutional endurance is positively associated with societies that have higher per capita GDP, are more democratic, and are more politically stable.<sup>136</sup> Although design

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<sup>131</sup> ELKINS ET AL., *supra* note 13, at 38–39.

<sup>132</sup> Laurie A. Ronholdt & Alex Pederson, *Tips For Drafting and Issues Presented by LLC Operating Agreements*, PRAC. TAX LAW., Fall 2008, at 7, 7 (“The operating agreement is the governing document for an LLC, in which the business relationship among LLC members, the activities in which the entity may engage, and administrative procedures for the LLC are all described.”).

<sup>133</sup> Other improvements could simply address some of the concerns about drafting detailed in Part III above, including providing better context for documents on electronic databases through consistent and detailed file organization and providing extensive (and again, consistent across departments) training for new transactional associates.

<sup>134</sup> See, e.g., Tom Ginsburg, *Constitutional Endurance*, in COMPARATIVE CONSTITUTIONAL LAW 112 (Tom Ginsburg & Rosalind Dixon eds., 2011) (noting that “constitutional scholars . . . have generally assumed that endurance is valuable.”).

<sup>135</sup> See Hirschl, *supra* note 16, at 1353 (“Endurance may be an intuitive criterion by which to measure the relative success of a given constitution.”); see also Ginsburg et al., *supra* note 23, at 216 (arguing that endurance is an important criterion for constitutional success).

<sup>136</sup> ELKINS ET AL., *supra* note 13, at 32–33.

theorists make no claim of causation,<sup>137</sup> the most prosperous nations in the world are among those with the longest tenured constitutions.<sup>138</sup>

Aside from the economic benefits associated with constitutional endurance, prevailing constitutional design theory suggests that document endurance is beneficial because it fosters a sense of national identity and unity.<sup>139</sup> This viewpoint is in contrast to some American founders' views that periodic review and generationally timed replacement would accommodate better institutions, keep the public more active in the process, and better reflect changes in technology and constituencies.<sup>140</sup> To the contrary, empirical studies reveal that frequent replacement results in less innovation and perhaps more vacillations.<sup>141</sup>

The following sections first make the case that endurance is a proper objective and framework for structuring some business enterprises and then describe the components of enduring design identified in the constitutional design literature.

### A. *The Normative Case*

Scholars argue that endurance is appropriate, from a normative standpoint, for constitutional design.<sup>142</sup> That is, scholars defend the validity of the underlying assumption that constitutions, particularly those for formative democracies, *ought* to be written to endure.<sup>143</sup> Enduring constitutions promote civil obedience because the

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<sup>137</sup> *Id.* (recognizing that statistical associations do not necessarily demonstrate a causal relationship).

<sup>138</sup> Ginsburg, *supra* note 134, at 115 (“The suggestive evidence is strong, however: . . . no rich democratic country has had high levels of constitutional turnover, while nine of the ten longest currently living constitutions belong to [the Organisation for Economic Co-operation and Development] members.”).

<sup>139</sup> ELKINS ET AL., *supra* note 13, at 20 (noting that “constitutions can help instill in the citizenry a sense of shared identity.”).

<sup>140</sup> *Id.* at 22 (“Arguments on Madison’s side include a role in facilitating precommitment, binding a sometimes diverse and multitudinous citizenry, fostering the development of ancillary institutions, and a potential instrumental benefit in facilitating investment and economic activity. In most respects, the debate reduces to the perennial tension between flexibility and commitment.”); *see also* Ken I. Kersch, *The Talking Cure: How Constitutional Argument Drives Constitutional Development*, 94 B.U. L. REV. 1083, 1086–87 (2014) (“The [U.S.] Constitution is not an iron cage. We are not its prisoners. Although the road to change has often been bitter and hard-fought, the Constitution has always been subject to new, reordering interpretations capable of meeting new social, economic, and political challenges.” (citations omitted)).

<sup>141</sup> ELKINS ET AL., *supra* note 13, at 23–24 (noting that the Jeffersonian arguments may overstate the case that replacement brings innovation and finding instead “churn,” where despite replacing their constitutions frequently, countries “remain anchored to the same institutional choices,” and “cycling,” where “a country caught in the grip of two competing and irreconcilable groups will bounce back and forth between constitutions according to which group is in power.”).

<sup>142</sup> *See supra* note 135 and accompanying text.

<sup>143</sup> ELKINS ET AL., *supra* note 13, at 35 (“On balance, our sense is that enduring

rules are predictable and stable.<sup>144</sup> Endurance allows for the development of “collateral institutions” (like political parties) that are invested in the governing process and will resist rapid unnecessary changes, insisting instead on gradual measured change.<sup>145</sup> Endurance also assists in the bargaining process during the creation of the document because each side operates closer to a “veil of ignorance,” not knowing what position it may hold in the long-term future.<sup>146</sup>

The case for endurance as a normative goal in the business organizational context is more nuanced. In a government structure, a diverse citizenry has agreed to abide by a system of governance of behavior and social structure.<sup>147</sup> Participants have entrusted their safety and their fortune and have given up some level of autonomy to join the society, and as such, they want the stability that an enduring construct brings,<sup>148</sup> which may not always be the case in the formation of a small business organization.

In a small company, investors can have myriad motivations and temporal expectations for their investment time frame. Some will be investing with short-term gains in mind. For example, arbitrageurs who are seeking to take advantage of an announced takeover are by definition short-term investors who are not interested in the longevity of the structure or the viability of the company.<sup>149</sup> This lack of long-term motivation also extends to certain early-round investors, like venture capital or private equity firms, who seek a preferred return and then plan to cash out at the time

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constitutions are good for young democracies.”).

<sup>144</sup> Ginsburg, *supra* note 134, at 113; *see also* Hirschl, *supra* note 16, at 1354 (noting that “a constitution is supposed to accomplish, or at least facilitate, the accomplishment of substantive goals.”).

<sup>145</sup> Ginsburg, *supra* note 134, at 113; *see also* Hirschl, *supra* note 16, at 1340 (noting that constitutional design may “set the foundations for a nexus of political institutions and procedures that would allow for long-term unity, peace, and stability.”).

<sup>146</sup> Ginsburg, *supra* note 134, at 113–14 (“[S]tability is a distinct dimension of constitutional choice that can improve bargaining incentives. As time horizons lengthen, each drafter’s ability to predict the position she will hold in subsequent arrangements, and so the negotiation takes on the quality of a veil of ignorance. This might itself produce fairer or more impartial rules.”).

<sup>147</sup> *See* Michel Rosenfeld, *Contract and Justice: The Relation Between Classical Contract Law and Social Contract Theory*, 70 IOWA L. REV. 769, 847–56 (1985) (discussing Thomas Hobbes’ social contract theory).

<sup>148</sup> *Id.*

<sup>149</sup> *See* Robert Willens, *Tax Benefits of Merger Arbitrage Survive Code’s Hostility to Rate ‘Conversions,’* 92 J. TAX. 235, 236 (2000) (“[T]he arbitrageur will purchase the stock of the target corporation and sell an appropriate number of shares . . . of the acquiring entity. If the merger closes, the arbitrageur will earn the merger ‘spread’—the discount to the transaction price that existed when the trade was originated. The arbitrageur’s net profit is that spread, reduced by the interest cost associated with the funds procured to carry the positions and, of course, taxes. If these taxes . . . can be reduced by an amount that exceeds the added cost to carry the positions for the period necessary to turn the short-term capital gain into a long-term capital gain, the arbitrageur’s net profits will be correspondingly enhanced.”).

of a sale to another company or at the company's initial public offering.<sup>150</sup>

The initial public offering scenario itself is a helpful example when considering longevity of a private company. Commonly, founders initially choose LLCs or partnership structures for tax purposes during their formative stages so that the likely losses in the start-up phase will pass through to give the investors tax benefits in the first few years of the company's existence.<sup>151</sup> Then, when the company looks to make an initial public offering, it will often convert to the corporate form (so that it can be listed on a national exchange) and incorporate in Delaware.<sup>152</sup> Accordingly, founders often anticipate dramatic evolutions of company structures and organizational choices.

But not all organizations anticipate such dramatic evolution. In fact, most companies are small operations and likely intend to stay that way.<sup>153</sup> To the extent

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<sup>150</sup> THERESE H. MAYNARD, *MERGERS AND ACQUISITIONS: CASES, MATERIALS, AND PROBLEMS* 9–10 (3d ed. 2013) (“For . . . [venture capital (VC)] investors, the time horizon for use of their capital varies, but is usually somewhere between three to seven years. This means that when the VC firm invests its capital and buys stock in the start-up company, the VC firm usually considers its *exit strategy* as part of its overall investment decision. The goal of these financial investors is usually to obtain the return on their invested capital along with a certain rate of return on their investment. The VC (or [Private Equity (PE)]) investor's goal, however, often may be at odds with the founding shareholder(s) of the company, who frequently are entrepreneur(s) who closely identify with the business of the company. . . . Among the exit strategies typically considered by a VC or PE investor is the sale of the business to another company.”).

<sup>151</sup> Daniel S. Goldberg, *Choice of Entity for a Venture Capital Start-Up: The Myth of Incorporation*, 55 *TAX LAW.* 923, 925 (2002) (“The partnership/LLC structure . . . facilitates the pass-through of losses incurred in the business to the partners. Each partner includes on his tax return his distributive share of the partnership's losses from operations. In contrast, losses incurred by a corporation (other than an electing S corporation) remain in the corporation to be carried back or carried forward to the extent there is income to offset in past or future years. But the losses are not available for use by the shareholders themselves.” (citations omitted)); see also Bradley T. Borden, *The Allure and Illusion of Partners' Interests in a Partnership*, 79 *U. CIN. L. REV.* 1077, 1081 (2011) (“The complexity of the partnership tax rules derives in part from the nature of tax partnerships. Tax partnerships do not pay income tax; instead, all partnership income flows through to the partners, and they report it on their individual returns. Each partner reports a share of the income in accordance with the partnership tax allocation rules.” (citation omitted)).

<sup>152</sup> See STEPHEN J. CHOI & A.C. PRITCHARD, *SECURITIES REGULATION: CASES AND ANALYSIS* 401 (3d ed. 2012) (“Prior to going public, the business, the lead underwriter, and attorney will reconfigure the various ownership interests and state law entities into a single corporate form with common stock ownership. . . . As part of the process of reorganizing for the initial public offering, businesses incorporated in other states will typically reincorporate in Delaware.”).

<sup>153</sup> See Sandra K. Miller, *The Best of Both Worlds: Default Fiduciary Duties and Contractual Freedom in Alternative Business Entities*, 39 *J. CORP. L.* 295, 316 (2014) (“[C]ensus data from 2012 indicates that approximately 92% of American business enterprises reported receipts under \$1 million. Moreover, an astonishing 76% reported receipts under \$100,000. This data leads one to conclude that relatively small enterprises

that a private enterprise does not want or anticipate dramatic growth and change, document endurance may have a great deal of value. Given the significant legal costs of setting up an organization, one of the primary measures of value of the legal services may be the ability of the document to withstand the test of time. Thus some business clients may want and appreciate documents that are long-lived and resilient in the face of change.

For example, the owners of a local hardware store, a multimember dental practice, or restaurateurs may have very modest goals with respect to growth and evolution of the enterprise. Instead, the more natural changes for those smaller organizations will be members coming in and out of the company, the death of a member, the acquisition of another piece of property, restructuring of debt, and other changes that, although perhaps significant to the organization's identity, are not necessarily structural modifications. These are more incremental changes, which a well-crafted document can accommodate without needing to be completely rewritten.<sup>154</sup> Accordingly, the concept of endurance can be an appropriate touchstone for business attorneys creating these organizations.

It is entirely possible, however, that an enduring business organizational document would be nearly meaningless in certain circumstances. A company may endure in name and structure, but may change so significantly over time that the investors may be better served by redrafting an organizational document that more accurately reflects the new institution.<sup>155</sup> Endurance in that context is arguably not valuable to the initial client because although the bare bones framework is the same, the operation of the enterprise is not what the client had envisioned during the drafting process.

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constitute an extremely significant part of the American economy.” (citations omitted)).

<sup>154</sup> See Keatinge et al., *supra* note 119, at 417 (discussing the flexibility LLC organizers have in an environment of minimal statutory requirements).

<sup>155</sup> This occurrence parallels the philosophical puzzle of the Ship of Theseus, questioning whether the ship remained the same Ship of Theseus after the old planks of the ship were removed and replaced gradually piece by piece so that eventually the entire ship consisted of new material. See Bernadette Meyler, *Towards a Common Law Originalism*, 59 STAN. L. REV. 551, 591 (2006) (citing THOMAS HOBBS, *ELEMENTS OF PHILOSOPHY, THE FIRST SECTION, CONCERNING BODY* 99–100 (London, R. & W. Leybourn 1656)).

And so it goes with law firms, many of which trace their history by representation of a particular client. See, e.g., *History*, FRIDAY, ELDREDGE & CLARK, <http://fridayfirm.com/about-the-firm/history/>, archived at <http://perma.cc/9VGD-8WF7> (last visited Aug. 11, 2015). For example, the Arkansas law firm of

Friday, Eldredge & Clark traces its history to December 1, 1871, when attorneys George E. Dodge and Benjamin S. Johnson formed a partnership for the practice of law, representing what was then known as the St. Louis, Iron Mountain and Southern Railroad, one of Arkansas's first major legal clients. In 1982, Union Pacific Railroad Company acquired Missouri Pacific Railroad, and the firm continues to represent the dominant railroad in Arkansas.

*Id.*

An enduring framework that incorporates maximum flexibility can allow an institution to adjust to exogenous shocks, market fluctuations, personnel changes, and the like. But the day-to-day picture of the institution is less fixed; the organization may be dramatically changed in the way it operates or what it does.

Endurance by itself is an unrealistic objective for every agreement. When creating a constitution, the stakes are high and drafters have clear incentives to be deliberate and careful in structuring the national government.<sup>156</sup> But in the context of business organizations, many deals will be fairly simple, often with clients operating on a shoestring budget who wish to minimize legal costs.<sup>157</sup> Nonetheless, allowing the framework of endurance to inform the drafting process gives the attorney a fresh perspective in which to view the various structural choices and alternatives. If attorneys approach the organizational process mindful of the mechanisms that give rise to endurance in other contexts, they can overcome status quo bias in their drafting and produce arrangements that better inform client expectations and better reflect unique client objectives.

The obvious question is then, at what expense does this more deliberate and custom drafting come? If an approach designed for endurance significantly increases the legal bill, one can assume few clients will pay for such services. My response is threefold. First, endurance might not be an appropriate objective for every organizational agreement. The participants may decide that they want a short-term and inflexible arrangement, designed to accomplish a single narrow objective. The founders may also prefer to simply spend as little time and money on the formal arrangement as possible and work with a bare-bones structure that merely sets forth the ownership percentages and management authority, and provides some state law protections. In the same sense that a client might not want to hire a large expensive law firm to provide a basic agreement, the client might not want to pay any additional amount for a more custom product. One cannot fault startups on small budgets for minimizing their expenses, even if they risk getting a problematic document. Second, in Part V of this Article, I describe ways of incorporating the enduring design in ways that could actually provide for more efficient, and cost-effective, delivery of legal services. In particular, promoting standardization of language in private agreements and developing forms with readily accessible alternative provision not only allows for more conscious choices in drafting, but can also streamline the process. Third, as developed below in Part IV.B.3 on “Specificity,” increasing the time and expense of drafting an organizational document is not always a bad thing. Clients taking the time to make more decisions and invest more resources at the front end of a business relationship may be more committed to making the relationship last and to working through conflicts. While

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<sup>156</sup> See ELKINS ET AL., *supra* note 13, at 10 (discussing the importance and difficulties of establishing an enduring constitution in new democracies).

<sup>157</sup> See Krishnan S. Chittur, *Resolving Close Corporation Conflicts: A Fresh Approach*, 10 HARV. J.L. & PUB. POL'Y 129, 131 (1987) (“Because people generally avoid complex and expensive planning in small businesses, certain problems are difficult to anticipate even when the parties attempt to articulate mutual expectations. Absent an adversarial setting, they keep lawyer involvement to the minimum.” (citation omitted)).

it would be counterproductive to unduly bind partners with excessive front-end sunken costs, there is also value in sorting through significant potential conflicts early and, among other items, ensuring all parties agree with the dispute resolution mechanisms.

### *B. Components of Endurance*

Drawing from institutional design research related to constitutions, certain elements associated with longer-lived constitutions can facilitate more predictable and useful business organizational documents and at the same time address the problems that arise from overreliance on form or precedent documents. Endurance can inform the drafting process in a way that results in more stable business structures, more clarity in organizational choices, and more usable documents for clients. It can serve as a guidepost during the drafting process to advance client goals and provide better value to clients by facilitating resilience of the institution. A focus on endurance can also clarify the bargaining process and the stakes of the agreement at the outset. At the same time, more thorough negotiations and structures can mitigate the problems associated with disparate bargaining power and varying sophistication in business matters.

According to Professors Zachary Elkins, Tom Ginsburg, and James Melton, specific design features that make a constitution more likely to endure include flexible conditions that are easy to amend (and thus can adjust to political or social shocks), greater public involvement in the creation of the document and the maintenance of the institution, and specificity, which represents greater investment on the part of the drafters.<sup>158</sup> The professors “analyzed an original set of cross-national historical data,” and found that their “theory holds up fairly well. . . . [T]he design features that [they] expected to be consequential are indeed so. In particular, the amendment procedure, detail of the constitution, and a level of inclusiveness all seem to have a decided impact on constitutional endurance.”<sup>159</sup> The following sections unpack each of these elements, explain the findings of Elkins and his colleagues, and make analogies to the business context.

#### *1. Flexibility*

After the initial bargain is struck, parties to an organizational agreement often face numerous challenges in the operation of the enterprise, including dramatic and unanticipated changes in the environment in which the organization operates. If these changes fundamentally alter the incentives for the parties to remain committed to the entity and if the entity structure is unsuited to adjust to the changed circumstances, the entity’s days are numbered.

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<sup>158</sup> ELKINS ET AL., *supra* note 13, at 8, 78–92.

<sup>159</sup> *Id.* at 146.

Elkins and his colleagues suggest that in order to endure, “constitutions require mechanisms for adjustment over time.”<sup>160</sup> Thus, constitutions are more likely to remain intact if they are flexible enough to be easily amended.<sup>161</sup> Given unpredictable—or rather, predictable but unknown—exogenous shocks that can alter the costs and benefits of the parties involved in the constitution’s creation, flexibility can allow a document to be modified as necessary to “adjust to the emergence of new social and political forces.”<sup>162</sup> A malleable document is more likely to be adjusted than jettisoned in its entirety.<sup>163</sup>

Measuring ease of amendability by both formal amendment procedures and observed amendment rate,<sup>164</sup> Elkins and his colleagues found support for their theory that “constitutions with lower thresholds for amendment will be more flexible and likely to survive in the face of constitutional crisis.”<sup>165</sup> However, these benefits do not extend to an unlimited degree of flexibility.<sup>166</sup> Too much flexibility can undermine a document’s longevity in unpredictable ways.<sup>167</sup> Without sufficient stability in its governing document, a nation may be unable to provide and enforce lasting rules of conduct for itself and its population.<sup>168</sup> But absent extreme flexibility,

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<sup>160</sup> *Id.* at 81.

<sup>161</sup> “The main point is that the existence of *some* method for adjustment to changing conditions over time forestalls pressure for more total revision.” *Id.* at 83; *see also* Hirschl, *supra* note 16, at 1349 (“As is well known, the amending procedures of some constitutions (e.g., the United States) are distinctly rigid and thus quite ineffective in allowing for self-adjustment. Amending formulae elsewhere (e.g., Germany) are more flexible, thereby allowing for adjustments while still entrenching the basic rules of the political game. As the U.S. example illustrates, overrigid constitutions may lead to fierce debates concerning interpretive approaches (e.g., the living constitution vs. originalism), as interpretation, not amendment, becomes the main constitutional adjustment mechanism.” (citations omitted)).

<sup>162</sup> ELKINS ET AL., *supra* note 13, at 82.

<sup>163</sup> *Id.* at 99 (explaining that an “amendment operates as a substitute for constitutional replacement, and often a more desirable substitute given the higher costs of replacement.”); *see also* Albert, *supra* note 126, at 380 (“Malleability, impressionability, and manipulability—those are the defining characteristics of a constitution according to the functional conception of constitutionalism.”).

<sup>164</sup> ELKINS ET AL., *supra* note 13, at 100.

<sup>165</sup> *Id.* at 99.

<sup>166</sup> Albert, *supra* note 126, at 407 (“On the one hand, flexibility is an asset because it allows a constitutional community to develop organically, to meet pressing needs, or even to respond to crises that the textual amendment procedures cannot accommodate either for time constraints or because of exacting supermajority thresholds. On the other hand, this measure of flexibility risks undermining the transparency that constitutionalism should foster.” (citation omitted)); *see also* ELKINS ET AL., *supra* note 13, at 81–83 (discussing the strengths and weaknesses of a flexible constitution).

<sup>167</sup> *See* Albert, *supra* note 126, at 407; *see also* ELKINS ET AL., *supra* note 13, at 82 (“To be sure, if taken to an extreme, flexibility undermines the very notion of constitutionalism as a set of stable limits on ordinary politics. If a constitution is completely flexible, . . . it may not be able to provide enduring rules that bind the polity together.”).

<sup>168</sup> ELKINS ET AL., *supra* note 13, at 82.



amendment procedures that facilitate both formal and informal adjustments in a constitution will increase its lifespan.<sup>169</sup>

Business entities, like governments, can benefit from the flexibility to adjust to changing conditions.<sup>170</sup> Where a state might have to respond to a new threat to national security, substantial change in population (numbers or makeup), or rapid inflation, a business might have to adjust to new marketplace competitors, the loss of key shareholders or managers, or declining demand for its products.

The choice of entity itself can reflect this needed flexibility. LLCs are often favored for their relatively flexible structures,<sup>171</sup> whereas S corporations (with their restrictions on the kind and number of eligible investors) are eschewed by many formative stage enterprises.<sup>172</sup> But the mechanisms for amending the organizational document itself are also important.

The degree of flexibility incorporated into an organizational document exists on a spectrum, and attorneys and investors have a wide range of choices by which to include it into the business structure. Where and how flexibility is achieved may impact the level and type of endurance that is facilitated. In general, flexible amendment procedures in constitutions result, the empirical evidence suggests, in longer lasting constitutions—the documents themselves are less likely to be completely abandoned rather than amended to adjust to new challenges.<sup>173</sup> On the business side, the appropriate inquiry, when deciding where and how to include flexibility, perhaps should be on whether the investors value stability of the document itself versus stability of the business operation.

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<sup>169</sup> *Id.* at 100.

<sup>170</sup> See Terence C. Krell, *Organizational Longevity and Technological Change*, 13 J. ORGANIZATIONAL CHANGE MGMT. 8, 9 (2000) (“Different types of organizations are required to deal with different types of environments, with the result that, as environments change, so must the organization. The more rapidly changing the environment, the more dynamic and flexible the organization must be.”).

<sup>171</sup> Richard A. Mann et al., *Starting from Scratch: A Lawyer’s Guide to Representing a Start-Up Company*, 56 ARK. L. REV. 773, 803 (2004) (“LLCs are specifically designed to be more flexible than corporations and can be organized as manager-managed entities.”); Miller, *supra* note 100, at 354 (“In the LLC context, the contractarian framework now offers LLC investors unparalleled freedom to limit their legal rights and responsibilities.”); Ronholdt & Pederson, *supra* note 132, at 7 (“An LLC is a flexible entity and members may creatively structure profits, losses, allocations and distributions, and many other elements of their relationship in ways that are unavailable to some other entity forms.”).

<sup>172</sup> See 26 U.S.C. § 1361(b) (2012) (requiring S corporations to have less than one hundred shareholders, permitting only individuals and certain types of trusts to be shareholders, prohibiting foreign shareholders, and allowing only one class of stock); *cf.* Eric C. Chaffee, *Business Organizations and Tribal Self-Determination: A Critical Reexamination of the Alaska Native Claims Settlement Act*, 25 ALASKA L. REV. 107, 144–45 (2008) (arguing that rather than requiring Alaska Natives to adopt the corporate form in order to benefit from the Alaska Native Claims Settlement Act, the drafters should have used LLPs or LLCs because their flexibility allows a group to determine its own governance structure).

<sup>173</sup> See ELKINS ET AL., *supra* note 13, at 99–100 (cautioning that the “effects of extreme flexibility” on constitutional endurance are uncertain).

The focus of constitutional design scholars has been the relative ease of amendment of the constitution<sup>174</sup> and the most direct analogy to the business setting is the amendability of the organizational documents. Amendment thresholds for organizational agreements vary from a majority vote of the equity holders (usually measured by interest, not per capita) at a quorum meeting to unanimous consent of all equity holders.<sup>175</sup> Generally speaking, most entities allow the operating (or partnership) agreement to be amended by a majority or supermajority of the vote (which voting interest is typically tied to capital investment).<sup>176</sup> It is difficult to argue against pairing member/partner votes with their relative investment in the enterprise. A person would be reluctant to contribute 50% of the start-up funding for a new organization if she were to only hold 10% of the voting power. Along those lines, changes to the organization that require amendment of the operating agreement should be accomplished only with significant consent from the members. Perhaps the concept of easy amendability then suggests favoring only a simple majority (as opposed to a supermajority) vote to amend. However, there are downsides to lower amendment thresholds for business enterprises, including the potential to undermine the expectations of investors when change occurs rapidly and equity holders are not able to decide whether to remain invested in the business before the change is implemented.

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<sup>174</sup> See generally *id.* at 99–103 (suggesting that “low thresholds for amendment will generally be associated with [constitutional] endurance.”).

<sup>175</sup> Ronholdt & Pederson, *supra* note 132, at 9 (discussing quorum and vote thresholds).

<sup>176</sup> This is a common statutory default. See, e.g., ARK. CODE ANN. § 4-32-403(a) (2001) (“Unless otherwise provided in an operating agreement or this chapter, and subject to subsection (b) of this section, the affirmative vote, approval or consent of more than one-half (½) by number of the members, if management of the limited liability company is vested in the members, or of the managers if the management of the limited liability company is vested in managers, shall be required to decide any matter connected with the business of the limited liability company.”).

Lower thresholds are more often present in organizations with numerous shareholders, and higher thresholds are more typical in very closely held entities.<sup>177</sup> One of the purposes of higher amendment thresholds in constitutional bargains is to protect minority interests.<sup>178</sup> State laws provide similar protection to shareholders in corporations by requiring class votes to approve any alteration (or transaction) that would negatively affect or significantly alter the rights of a particular class of shares.<sup>179</sup>

Consistent with constitutional design research, lower amendment thresholds will arguably support the endurance of organizational documents. But unlike drafters of constitutions and founders of nations, investors in a business perhaps do not have the same incentive to retain the organizational document itself. Exiting an equity position in a business entity is not revolutionary or particularly difficult; it is a relatively routine and anticipated occurrence in the business context. And unlike a new constitution, new business organizational documents can be easily created for the newly structured entity. In some instances, then, focus on the endurance of the document itself may be incomplete or illusory.

Business entities may also incorporate flexibility into their ongoing operations, which allows the entity to endure in the face of exogenous shocks. Businesses can choose from a variety of mechanisms to increase flexibility in the relative allocation of power among the participants and in day-to-day management. The organizational documents of unincorporated entities often provide a list of specific matters the managers, members, or certain partners are individually or collectively authorized to handle in the ordinary course of business, followed by a list of matters that require the consent of at least a majority of the other owners.<sup>180</sup> For example, an operating agreement might authorize the managing member to borrow money on behalf of the LLC, but require consent of a supermajority of the members to borrow an aggregate amount in excess of \$50,000 in any quarterly period.

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<sup>177</sup> Cf. Frank H. Easterbrook & Daniel R. Fischel, *Close Corporations and Agency Costs*, 38 STAN. L. REV. 271, 279 (1986) (“[C]ontractual mechanisms have evolved in response [to minority shareholders’ fears that those in control will favor themselves when distributing earnings]. These [mechanisms] include high voting and quorum requirements as well as employment and compensation agreements that make it difficult for those in control [of closely held corporations] to act without the consent of minority shareholders.”).

<sup>178</sup> See Michael Gentithes, *The Tiered Article V*, 34 WHITTIER L. REV. 307, 322 (2013) (“An amendment threshold set too low might release the hounds of majoritarian tyranny too readily, running roughshod over the rights of minorities previously thought to be fundamental or cementing a ruling coalition’s grip on the levers of power.”).

<sup>179</sup> See, e.g., DEL. CODE ANN. tit. 8, § 242(b)(2) (2015) (“The holders of the outstanding shares of a class shall be entitled to vote as a class upon a proposed amendment, whether or not entitled to vote thereon by the certificate of incorporation, if the amendment would increase or decrease the aggregate number of authorized shares of such class, increase or decrease the par value of the shares of such class, or alter or change the powers, preferences, or special rights of the shares of such class so as to affect them adversely.”).

<sup>180</sup> Ronholdt & Pederson, *supra* note 132, at 8–9 (discussing the managerial powers provided in statutes and the drafter’s task of customizing the document to reflect appropriate managerial controls for the particular entity).

Limiting the number and types of decisions that require consensus gives the individual owners the ability to more easily adjust to changes in the entity's environment. An executive imbued with extraordinarily strong powers can respond rapidly to changing conditions. Conversely, rigidity in the day-to-day management operations makes it more difficult for a business to respond and adjust to unpredicted events.<sup>181</sup> But naturally, such concentrated flexibility in authority carries the risk that the executive acts in a manner inconsistent with the preferences of even the vast majority of the organization's stakeholders.<sup>182</sup> Increased flexibility at the outset results in less control of what the business may look like in the future; the entity may operate much differently than it did when the agreement was formed.<sup>183</sup> Regardless of how they decided to allocate control and economic sharing at the formation of the entity, the owners retain the ability to alter these fundamental choices as the entity undertakes its operations.

Instead of incorporating flexibility in amending the organizational document or even in the operation of the business, perhaps a stronger analogy for endurance objectives can be made by evaluating the flexibility of the exit provisions for investors.<sup>184</sup> Constitutional drafters seeking to create long-lived structures minimize the risk of document and nation failure by allowing amendments in response to changing incentives for the parties; they want parties to remain invested in the nation and in the constitution itself.<sup>185</sup> In the business context, the members' commitment to the business entity is perhaps more accurately reflected in the restrictions on transfer of ownership units and how they can otherwise exit the bargain.

To be clear, promoting more enduring organizational documents is not to suggest that investors should be irrevocably committed to their business decisions. Mobility of capital is desirable, and investors need the ability to alter the allocation of their resources.<sup>186</sup> But the ease with which capital can enter and exit private investments gives the money contributor (as opposed to the property or services contributor) more power, both in the negotiation process and when the company is faced with external shocks that threaten its operations. The relative mobility of cash capital gives that investor more bargaining power. To the extent that focusing on

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<sup>181</sup> Among the upsides to a rigid structure is increased predictability, as management's range of options may be limited. See Gentithes, *supra* note 178, at 312.

<sup>182</sup> See J. William Callison, *Venture Capital and Corporate Governance: Evolving the Limited Liability Company to Finance the Entrepreneurial Business*, 26 J. CORP. L. 97, 113 (2000) (discussing how members in a manager-managed LLC "have relatively little control over the managers' actions and little ability to assure that managers act for the members' benefit rather than opportunistically.").

<sup>183</sup> See *supra* note 178 and accompanying text.

<sup>184</sup> Cf. Ronholdt & Pederson, *supra* note 132, at 9 ("Providing satisfactory means of exiting the LLC in the operating agreement is essential to preventing future conflicts among the members. In that regard, the drafter should address in the operating agreement the members' right to transfer their membership interests and withdrawal of a member and consider including buyout provisions as well.").

<sup>185</sup> See ELKINS ET AL., *supra* note 13, at 81–82.

<sup>186</sup> Bordoff & Furman, *supra* note 105, at 342 n.54.

endurance is designed, at least in part, to remedy an imbalance of power among the investors, the level of flexibility included in the transfer restrictions of an interest in a business may provide protections to those investors with less liquid contributions.<sup>187</sup>

For example, it is not uncommon for a private company to install a multilevel right of first refusal procedure for any owner wishing to transfer her ownership units.<sup>188</sup> Such a provision might require the investor wishing to transfer units first to offer the units to the company and allow it thirty days to exercise the option. If the company declines the option, then the investor must offer the units to the other members on a pro rata basis and allow them thirty days to exercise their option. The option may even provide the ability for either the company or other members to pay the purchase price with a promissory note payable over a number of years. Under that scenario, it is fairly cumbersome for the investor to exit the business. To the extent that investors agree from the outset on this provision, provided of course that they understand its implications, the members can feel fairly confident of each other's commitment to the entity and can feel secure that the business structure will endure. The amount of flexibility included in exit provisions can signal commitment to the company.

Ultimately, the flexibility incorporated into the document is a matter of contractual bargain among the participants, and the amount of flexibility exists on a spectrum, just as constitutional flexibility exists on a spectrum.<sup>189</sup> Businesses can include much flexibility in the procedures and votes required to amend the organizational documents and in the level of day-to-day control that managers have. Great flexibility in these areas allows the company the ability to adjust to any number of changes, both in the external environment and in the makeup and goals of the participants. But that flexibility also opens the possibility that the organization, although still existing in name and original documents, will look and function very differently from what was originally planned. On the other end of the spectrum is a document that is very rigid because it is not easy to amend, gives little control or flexibility for owners to deal with exogenous changes, or makes it difficult for individual investors to exit. That business will have more predictability and certainty in how it will operate down the road, but may have difficulty adjusting to changes along the way without reorganizing.

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<sup>187</sup> See Molitor, *supra* note 102, at 527 (advocating consideration of transfer restrictions to protect minority shareholders).

<sup>188</sup> Ronholdt & Pederson, *supra* note 132, at 10 (“An alternative to requiring member consent to all transfers is to provide for a right of first refusal when a member desires to sell [their] interest in the LLC. The right of first refusal requires a member, before selling his or her interest, to offer the membership interest to the other members on the same terms as the member offers to sell to an outside party. This affords the remaining members the option to buy out the selling member rather than allowing admission of a new member with whom the remaining members may not want to associate. The right of first refusal provides a good balance of maintaining the exiting member's right to liquidity of the membership interest and the remaining members' right to decide with whom they want to be in business.”).

<sup>189</sup> See *supra* notes 170–173 and accompanying text.

In each case, the impact of endurance will be different and it is up to the investors individually and as a group to decide on the strategy that is best for them and their business. The more often that drafting attorneys make the flexibility-endurance-predictability analysis part of the decision-making conversation at the outset, the better it bodes for the health of the institution, whether in terms of longevity or other goals. Investors will be making a conscious decision on the desirability of both the longevity of the business and the resilience of the organizational document.

## 2. *Inclusion*

The level of inclusion in the constitutional setting refers to how many different perspectives are represented in both drafting the document and the ongoing enforcement of the bargain.<sup>190</sup> Formative-stage constitutional inclusion is manifested through involvement in the “writing, deliberation, and approval” process of the document,<sup>191</sup> which consists primarily of deliberation by a publicly elected political body and ratification through public referendum.<sup>192</sup> Thereafter, inclusion in ongoing constitutional enforcement is manifested through public election of political leaders, direct democracy initiatives, and direct public challenges of legislation on constitutional grounds.<sup>193</sup>

Design and implementation processes that involve more stakeholders are believed to promote continued adherence to the agreement “by increasing the visibility of the document and demonstrating societal consent” and “by increasing the stake that citizens have in the document and their attachment to it.”<sup>194</sup> People who are more aware of the contents of the document have both a greater allegiance to it and more respect for it as a governing instrument.<sup>195</sup> Elkins and his colleagues posit a reciprocal connection between attachment of the people to the constitutional bargain and its ultimate survival: “framers and citizens will protect a document to which they are attached and documents that survive will in turn engender norms of

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<sup>190</sup> ELKINS ET AL., *supra* note 13, at 78.

<sup>191</sup> *Id.* at 98.

<sup>192</sup> *Id.*

<sup>193</sup> In particular, to evaluate inclusivity both in the constitution making and in ongoing governance, ELKINS ET AL., *supra* note 13, created an index of eight measures of inclusivity: “public referendum or publicly elective deliberated body; elected head of state; elected legislature; public can challenge constitutionality of legislation; citizen initiatives; citizen referenda; recall of legislators; and recall of the executive.” *Id.* at 99 n.3.

<sup>194</sup> *Id.* at 81.

<sup>195</sup> *Id.* at 78 (“Successful constitutions generate allegiance from those among later generations who do not initially consent to them, much less participate in the drafting of the texts.”); *see also* Kersch, *supra* note 140, at 1088 (arguing that much of the success of conservative political leaders in the U.S. is due in large part to that party’s use of constitutional political rhetoric to revitalize “the main lines of constitutional discussion in America”).

attachment.”<sup>196</sup> In this way, inclusion in both the drafting and ongoing enforcement of a document “generate[s] the common knowledge and attachment essential for self-enforcement.”<sup>197</sup>

A comparable approach to inclusion at the formation of a business enterprise would incorporate significant input from each of the primary equity holders, regardless of the form of their contributions. Obviously, all participants in a business enterprise actively choose whether to invest in the organization. This is in contrast to a nation-state where, even at the formative stages of the government, many who would have chosen not to be part of the constitutional bargain are nonetheless pulled within its authority by virtue of their residency. And although citizens do have the ability to relocate, there is a default position of constituency in some government. The default for the potential business investor is nonparticipation.

Notwithstanding these distinctions, inclusion’s furtherance of longevity in the constitutional setting likewise suggests incorporating inclusion into the business organizational drafting context. To the extent business owners are motivated by endurance of the enterprise, it is critical that the owners’ commitment to participate was an informed decision.

Further, endurance can be enhanced by meaningful continuous involvement by the participants. This is not meant to decry entities like traditional limited partnerships with whole classes of owners that do not participate in management. Instead, it suggests that the equity holders’ perception of the enterprise’s legitimacy, and accordingly its sustainability, are supported through structural means similar to participatory democracy.

In the context of most small entities, participation in drafting or in ongoing operations is not terribly difficult; members can fairly easily get attention to make their opinions and preferences known.<sup>198</sup> But the key to true inclusion, inclusion that results in an enduring organization, is that such participation must be informed. Thus, at both of those crucial points of time—the initial document creation and the ongoing enforcement of the bargain—the structure, content, and format of the organizational documents themselves can facilitate inclusion. Further, true and knowing inclusion of all stakeholders is promoted when the documents are in a usable format and when the content of the documents is visible and easily accessible.

Very often, attorneys defer to the most business savvy or most communicative partner when outlining the entity structure.<sup>199</sup> If the attorney represents only one

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<sup>196</sup> ELKINS ET AL., *supra* note 13, at 78.

<sup>197</sup> *Id.*

<sup>198</sup> For an analysis of shareholder inclusion in the context of public corporations, compare Stephen M. Bainbridge, *Director Primacy and Shareholder Disempowerment*, 119 HARV. L. REV. 1735, 1751 (2006) (advocating for the efficiency benefits of the director primacy that limits shareholder voting rights), with Grant Hayden & Matthew T. Bodie, *Shareholder Democracy and the Curious Turn Toward Board Primacy*, 51 WM. & MARY L. REV. 2071, 2112–20 (2010) (criticizing the theory of board primacy and suggesting an alternative theory that expands the corporate voting system by treating other corporate constituents (creditors, employees, consumers, etc.) like shareholders).

<sup>199</sup> Moore, *supra* note 108, at 678 (“The problem is most acute in closely held

investor, then indeed, the attorney's role is to do just that—to promote provisions that place the individual client in the best position given her unique objectives. But if the attorney represents the organization (or multiple investors) in the formation process, then the attorney has an obligation to take a more balanced approach.<sup>200</sup> A drafter concerned with the long-term viability of the document should carefully explain each of the key decision points in the agreement and ensure that even the least experienced participants understand the choices and their alternatives.

This approach suggests using straightforward language and streamlining the agreement. Indeed, the more standardized the language is, the more easily translatable the agreement is, and the more easily it can be absorbed by a novice investor.<sup>201</sup> Use of standardized language is not intended to suggest a reversion to fill-in-the-blank form documents, but rather to documents that use clear and consistent language and are accepted and widely adopted in a practice area, in a

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corporations and small partnerships where . . . distinguishing between representation of the entity and its individual members is more difficult. This difficulty exists because, unlike the publicly held corporation, the ownership and management are substantially identical. As a result, even entities in which a single dominant shareholder does not exist, counsel 'typically will have regular contact with [the owners] and may well have personal relationships with some or all of them, each of whom is likely to have a significant financial stake in the enterprise.' In this context, it is difficult, if not impossible, to determine who speaks on behalf of the entity. Rather, 'counsel is more likely to find individual participants attempting to realize their personal goals through the enterprise.' Because these individuals often have the legal authority to direct the affairs of the business, neither counsel nor the individuals are likely to distinguish between advising the entity and advising the individual constituents.'" (alteration in original) (quoting Mitchell, *supra* note 104, at 479)).

<sup>200</sup> Cf. Mitchell, *supra* note 104, at 477–79 (explaining that, "[c]ounsel to the close corporation may often find it difficult to determine who speaks for th[e] 'entity' the [Code of Professional Responsibility and the Model Rules of Professional Conduct] insist she represents. She will particularly be stymied in making this determination when the distribution of ownership is relatively equal, for under such circumstances each shareholder will legitimately expect that the corporation will fulfill his individual interests." (citation omitted)); Moore, *supra* note 108, at 679 ("[T]here is a presumption that entity lawyers represent only the entity itself and not the individuals unless the specific circumstances show otherwise. Unfortunately, it is not at all clear what circumstances suffice to demonstrate individual representation in a particular case. According to the ABA Standing Committee on Ethics and Professional Responsibility, '[w]hether such a relationship has been created almost always will depend on an analysis of the specific facts involved. The analysis may include such factors as whether the lawyer affirmatively assumed a duty of representation to the individual . . . , whether the [individual] was separately represented by other counsel when the [organization] was created or in connection with its affairs, whether the lawyer had represented an individual . . . before undertaking to represent the [entity], and whether there was evidence of reliance by the individual . . . on the lawyer as his or her separate counsel, or of the [individual's] expectation of personal representation.'" (quoting ABA Comm'n on Ethics & Prof'l Responsibility, Formal Op. 91-361 (1991)).

<sup>201</sup> See Molitor, *supra* note 102, at 577–78 (advocating for standardized business organizational documents using plain English).



region, or at least within a law firm.<sup>202</sup> An organizational document, like any legal contract, that is clear and usable will result in members who understand the nature of their investment, the risks and benefits they face, and the options they have as part of the entity.<sup>203</sup> Investors will be more committed to the organization and to the document because, from the beginning, the specifics of the agreement will be more transparent and the choices they are making will be more informed. Parties to a business entity agreement will better understand the content of the document and how the choices during the formation process will impact them.

In addition to a more informed decision to participate, clearly drafted organizational documents will result in more inclusion and commitment in the ongoing operations of the business. Investors who enter into an agreement informed about their commitment and the risks they face in the operation of the business will more fully respect the bargain. Even adverse consequences from a business decision will more likely be accepted as legitimate when investors were aware on the front end of the possible outcomes. They will be less likely to claim that they were not consulted in the document drafting or that one party was intentionally misleading. Inclusivity thereby deescalates otherwise potentially troubling situations and may in fact push the parties toward a compromise or at least an acquiescence as to the next steps for the business.

From an even broader perspective, an inclusive drafting approach could incorporate input from non-equity holders. Clearly, the business entity's ongoing relationships with lenders, bondholders, employees, regulators, and others outside of the organization itself will have a significant impact on its long-term viability.<sup>204</sup> Although these non-owner stakeholders will not necessarily have the power to dictate the terms of the document or to modify the agreement, soliciting input from them can nonetheless promote the long-term health of the organization. Involving outsiders in the structuring, planning, and drafting processes from the beginning can increase the visibility of the bargain, eliminate asymmetries of information, and identify uncertainties and vulnerabilities in the structure.<sup>205</sup> The equity holders then

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<sup>202</sup> See *infra* part V.B.

<sup>203</sup> See Molitor, *supra* note 102, at 577–78.

<sup>204</sup> Davis, *supra* note 49, at 99 (“The value of a contract to the parties who adopt it may also depend on the extent to which third parties are uncertain about its effects. This is most likely to be the case if the parties to a contract value the ability to transfer interests in it to the third parties in question, either directly or indirectly.”); see also Michelle M. Harner, *Corporate Control and the Need for Meaningful Board Accountability*, 94 MINN. L. REV. 541, 546, 580–94 (2010) (recognizing the value of the corporate monitoring function of activist shareholders, creditors, and debt holders in the corporate context, and suggesting that board decisions influenced by these stakeholders be treated in a manner similar to board transactions with interested directors to temper any self-interest concerns, rather than imposing special fiduciary duties on these parties).

<sup>205</sup> See Stefan J. Padfield, *In Search of a Higher Standard: Rethinking Fiduciary Duties of Directors of Wholly-Owned Subsidiaries*, 10 FORDHAM J. CORP. & FIN. L. 79, 107–08 (2004) (discussing the historical limitations of the board of directors' legal duties to outsiders and the movement to “improve the extent to which stakeholder interests were protected, or

can take this input and incorporate it into their organizational documents in a way that can mitigate problems down the road by clarifying expectations, facilitating common knowledge, and garnering more investment in the bargain.

However it is accomplished, it behooves drafting attorneys to create organizational documents with inclusion in mind as a way to increase the longevity of the organization and the commitment of its members. By clearly communicating options to investors on the front end and by soliciting input from non-owners, attorneys can employ organizational documents in a manner that facilitates informed participation and increased attachment to the business entity.

### 3. *Specificity*

Specificity in constitutional drafting refers to both scope and detail.<sup>206</sup> By scope, Elkins and his colleagues referred to the number of issues covered by a particular document “as a percentage of some ninety-two possible topics.”<sup>207</sup> By detail, they referred to “precision and elaboration” of those topics, measured by calculating the average number of words on any given topic.<sup>208</sup>

Although drafting for specificity takes time and political bargaining,<sup>209</sup> investing that effort upfront can alleviate the problems of hidden information and disparate expectations.<sup>210</sup> Additionally, specificity can aid in enforcement by providing clear and detailed information about the underlying terms of the bargain as represented in the final document.<sup>211</sup>

Although the U.S. Constitution is itself loosely drafted in a way that has facilitated its longevity,<sup>212</sup> specificity can enhance endurance for three reasons. First, specificity prompts more thorough bargaining and negotiation at the outset by

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at least considered, during times of dramatic corporate change.”).

<sup>206</sup> ELKINS ET AL., *supra* note 13, at 84, 103; *see also* Hirschl, *supra* note 16, at 1343 (noting that “size and scope matter” in constitutional design).

<sup>207</sup> ELKINS ET AL., *supra* note 13, at 104.

<sup>208</sup> *Id.* at 103, 105.

<sup>209</sup> *Id.* at 84 (“Specificity requires careful drafting and hard bargaining, both of which take time and political resources.”).

<sup>210</sup> *Id.* at 68–72.

<sup>211</sup> *Id.* at 84 (“[T]he clarity and specificity of the constitutional contract may be helpful in providing an incentive for, and facilitating, enforcement. A clearer, more specified document will more easily generate shared understandings of what it entails.”).

<sup>212</sup> *Id.* (“There is a near-consensus among American constitutional scholars and advisors that a loosely drafted framework constitution is superior to a more specific one. The belief is that the U.S. constitution has endured precisely because it has not specified details, but left them instead to ordinary law and custom.”); Albert, *supra* note 126, at 406 (“[T]he United States Constitution is flexible, written in broad strokes, and outlines a basic structure of government, collective purpose, and citizen rights and responsibilities, with the preponderance of the details left to be added later by legislative, executive, judicial, and civic actors. This hints at a connection between constitutional flexibility and constitutional specificity that is worth pursuing. It may be best examined through the prism of constitutional change.”).

requiring parties to anticipate issues that may arise.<sup>213</sup> Second, it is costly, and the greater upfront investment will prod constituents to work with the existing document as necessary rather than redrafting it completely.<sup>214</sup> And third, “[s]pecificity incentivizes *ongoing* investments in the constitutional text” because parties will need to monitor the document to make sure the scope and details of issues it contains remains current and accurate.<sup>215</sup> Thus, a constitution with greater depth and breadth of coverage can facilitate rather than impede endurance.<sup>216</sup>

For the same reasons that specificity can help a constitution endure, specificity can add value to the drafting of an organizational agreement and its ongoing enforcement. Although few would suggest increasing the word count in most operating agreements, organizational contracts that plainly address more issues are likely to be more useful to the clients if—and this is a huge if—the clients understand the choices made on those issues as well as their alternatives. If the parties to the bargain understand the decision points, have input on those decision points, and give the drafting attorney guidance on how to address them in the agreement, the document will likely have staying power. Further, if the parties discuss issues specifically in the drafting process, but ultimately leave them out of the agreement, the document reflects still a more complete bargain because the omission is intentional and all parties are informed.

Thus, addressing a larger number of organizational choices in more detail encourages participants to disclose information and expectations earlier in the process.<sup>217</sup> These issues are likely more easily addressed in the drafting process than in the operating phase of the entity.<sup>218</sup> Thus, organizational documents that address more issues in a clear and concise manner can facilitate the discussion of each of the decisions that must be made at the time the entity is established.

As in constitutional drafting, more discussion and negotiation during the drafting stage of a business document, although time intensive and costly, can help

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<sup>213</sup> *Id.* at 86–87.

<sup>214</sup> “[S]pecificity of a written constitution represents a certain amount of sunk-cost investment that cannot be recouped should the constitution fail. The greater the investment in a particular constitutional bargain, the less willing parties will be to deviate from it by switching to a new bargain.” *Id.* at 87.

<sup>215</sup> *Id.*

<sup>216</sup> *Id.* at 88 (“A constitution covering more topics will tend to incentivize more interest groups toward enforcement, whereas depth helps them develop shared understandings of what the constitution requires and allows.”).

<sup>217</sup> Dent, *supra* note 76, at 308 (“Counsel must be able to anticipate future problems and fashion solutions to them. In so doing they must decide what issues can be left open until later and which should be resolved at the outset, which in turn raises questions of how important various questions are to the parties. Thus, counsel needs an understanding of what problems can arise for a particular firm as it grows and the special needs of its particular parties.”).

<sup>218</sup> See Molitor, *supra* note 102, at 495–96 (arguing that the best way to protect minority owners is at the organization formation stage rather than by litigation after an issue has arisen).

alleviate problems associated with hidden information and disparate expectations.<sup>219</sup> The number of different issues addressed by the organizational document can be a proxy for a more thorough bargaining process, which can bring to the table issues and expectations of the investors. Additionally, the added investment of time in creating the business organization encourages participants to commit to the document, as a product of their time and effort, and to the entity they themselves helped create.

Specificity is not always, in either the constitutional drafting setting or the business context, a proxy for increased complexity of the document. Most organizational documents are indeed highly intricate and complex and include pages and pages of provisions governing numerous aspects of the business organization. But the benefits of specificity—of increased scope and detail of issues covered—are lost when clients are unable to understand the stakes of organizational decisions. Rote drafting and perfunctory reliance on precedent agreements can result in organizational documents that are extremely intricate, but not in a way that advances the specificity that institutional design scholars seek.<sup>220</sup> Rather, specificity that promotes endurance must be housed in a document that is readable and usable. Only then will the entity and its investors reap the benefits of the depth of coverage in terms of fruitful negotiations at the outset, clearer understanding of the choices made in the document, and more informed participation in the entity's ongoing operations.

#### V. INCORPORATING ENDURANCE INTO BUSINESS DRAFTING

Recognizing the value that deliberate drafting can bring to the institutional bargaining process, this section imports the elements of enduring constitutional design into the business design context. Even if institutional longevity is not a prevailing motivation of the organizers, the process of structuring business entities and drafting their formative documents can be enriched by incorporating certain aspects of constitutional design that are associated with endurance. One benefit of this process indeed may be longer-lived organizational documents, but in many cases other benefits are more likely and prevalent.

Fundamentally, both the constitutional bargain and the organization of a business enterprise involve previously autonomous parties subjecting themselves to a governing regime with the mutual goal of enhancing the welfare of the participants. In each case, the parties to the agreement are bargaining in an environment of asymmetrical information while facing many uncertain future events over which the entity and its stakeholders have limited control. A serious testing point for each arrangement is when a structural element incorporated at inception later provides an

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<sup>219</sup> See *supra* notes 206–211 and accompanying text.

<sup>220</sup> See Charles J. Goetz & Robert E. Scott, *The Limits of Expanded Choice: An Analysis of the Interactions Between Express and Implied Contract Terms*, 73 CALIF. L. REV. 261, 265 (1985) (“More complex and finely calibrated instruments generally offer improved results. Unfortunately, intricate, special-purpose instruments may also invite disaster if put to unintended uses, or if the instruments themselves have been inadequately designed and tested.”).

advantage to certain parties relative to other participants. Whether that advantage is construed as a trap, a calculated risk, or a negotiated concession depends in large part on transparency and thoroughness of the bargaining process. An open and detailed negotiation at the formative stage of government or business collaboration enhances the perceived legitimacy of the arrangement and increases the likelihood that the bargain will endure in the wake of potentially destabilizing developments.

As outlined above, scholars have associated certain design elements with constitutional endurance, including inclusion, amendability, and specificity.<sup>221</sup> Integration of these components not only enables the institution to function in a variety of rapidly evolving environments, but also directs the discussion at formation in a manner that promotes resilient commitment of institutional participants. The following sections explore what inclusive, flexible, and specific organizational design and drafting might entail for business entities.

#### A. *Form Documents with Alternative Provisions*

The attorney for the organizers of a business entity can approach formative stage investigation, guidance, and drafting in a manner that facilitates an inclusive bargaining and governance procedure. By utilizing a drafting process that encourages thoughtful discussion of the key provisions and important choices that the founders should make, attorneys can include all key parties in a meaningful dialogue about the document being crafted.

In a largely document-driven practice setting, the forms employed by business counsel have a tendency to cabin the organizing discussions within the open or obviously deal-specific terms. For an LLC's operating agreement, the vast majority of the preformation dialogue may address the members' holding structures, contributions, sharing ratios, and perhaps the organizational purpose, as these terms seldom can be retained from a prior agreement. The attorney's propensity to isolate and address the "blanks" in the operating agreement template seriatim is exacerbated by the use of precedent documents or forms that do not include alternative provisions.

Instead of starting the negotiation and drafting process with a version of the operating agreement that has previously customized provisions, attorneys could craft form documents that instead identify the various alternative choices for key provisions.<sup>222</sup> Evaluating each option and making a conscious selection will spur the attorney to consider the maximum number of alternatives and therefore to address those issues during the negotiation process with the participants of the entity. In that way, each founder and organizer of the enterprise begins the business relationship aware of the choices and the possibilities for the organization's formation.

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<sup>221</sup> See *supra* Part IV.

<sup>222</sup> See Goetz & Scott, *supra* note 220, at 286 (suggesting that "[p]roviding a menu of instructions from which parties can choose greatly simplifies and reduces the cost of contracting[,]” and that “[p]reformulations[, or standardized terms,] bring to bear a collective wisdom and experience that parties are unable to generate individually.”).

Clearly delineating the alternatives for key provisions and requiring participants to make deliberate choices reduces the biases associated with preexisting provisions and boilerplate language. It mitigates the status quo bias that drafting attorneys have toward choices made for prior agreements, and it encourages clients to discuss among themselves the benefits and risks of each option so that when problems arise later, the participants have made a conscious decision about how to handle the situation.

For example, most simple LLC agreements will provide for allocations of income and losses according to sharing ratios, which in turn are usually tied to the agreed value of initial contributions. If the precedent document with which the attorney begins the drafting process includes such a provision, it is unlikely to be changed absent a specific request from the organizers.<sup>223</sup> A drafter might consider giving the organizers more options when working from a form that includes alternative provisions for a preferred return to certain partners or for special allocations of income or loss items, along with appropriate modifications to account for tax consequences of such allocations. Taking this approach, attorneys and organizers alike can better appreciate the available options, rather than relying too readily on choices made in precedent documents.

Further, instead of providing that distributions will simply be made in proportion to sharing ratios, the attorney might want to consider presenting the organizers with alternatives that incorporate drawing accounts or guaranteed payments to members contributing services regularly. Among the most contentious provisions for which options should be discussed are valuation of the member's interest (e.g., as a going concern or with discounts for marketability or lack of control) and whether to incorporate rights of first refusal for member interests, and options to purchase a member's interest at the termination of employment with the entity or the loss or suspension of a professional license. Merely selecting from among these provisions should at least encourage the drafter to consider whether less frequently used alternatives are appropriate or worth discussing among the organizers of a unique entity. Aside from spurring discussions among the clients, the attorney's selection merely involves deleting the unused alternatives, adding only a few minutes to the drafting process.

Encouraging discussion of the alternatives by facilitating methodical review of the choices in the document results in increased inclusion of the investors, but, more importantly, more informed and meaningful inclusion. If one of the members wants to transfer a portion of his interest one year after the organization of the LLC and only then discovers that the interest is subject to a right of first refusal in which the company or other members can purchase the interest on terms unfavorable to the transferring member, that member is likely to be frustrated and suspicious of the other members and the drafting attorney. If however, alternative structures were discussed and this method was perceived as a deliberate concession at the inception of the entity, then the member can anticipate these transfer restrictions and plan accordingly without the specter of deception or even lack of adequate disclosure.

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<sup>223</sup> See Miller, *supra* note 100, at 407.

Although a thorough review of the document without alternatives can alleviate these concerns to some degree, presenting each member with a range of choices gives even more credibility to the process and more informed commitment to the bargain.

*B. Uniform Language in Private Agreements*

Although Part II.A. of this Article detailed the pitfalls of rote drafting and blind adherence to previously used contractual language, there is still significant value in promoting similar, if not uniform, language in private agreements.<sup>224</sup> Indeed, a more standardized approach to drafting organizational documents like operating agreements and partnership agreements could facilitate a better informed and thorough bargaining process through each of the alternative provisions, making it more efficient to navigate the options for both the attorney and the client. Despite the similarities in structure and purpose of the documents employed to organize and govern unincorporated entities, the language of these documents varies widely among lawyers, law firms, and industries.<sup>225</sup> For example, the following two provisions extracted from draft operating agreements establish largely similar conflicts of interest policies, but using different terminology:

Transactions with Affiliates. Unless otherwise agreed in writing by all Members, each Member shall disclose any and all direct or indirect affiliation with or interest in any Person with which the Company proposes to do business or enter into any financial transactions. The Company may enter into agreements with one or more Members or Affiliates of a Member provided that any such agreement shall be at rates and terms at least as favorable to the Company as those available from unaffiliated parties.<sup>226</sup>

Conflicts of Interest. Unless otherwise approved by all of the Members, any transaction between the Company and any Member shall be effected in a manner consistent with the manner in which the transaction would be effected between the Company and an independent third party bargaining at arm's length. Prior to entering into any material transaction with the Company, the Member shall disclose the material terms of such transaction to all of the Members.<sup>227</sup>

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<sup>224</sup> See Patterson, *supra* note 48, at 327 (“[The cost-saving] advantage of standard contracts is increased when there is a second layer of standardization under which multiple firms agree on a standard contract.”).

<sup>225</sup> See *supra* note 9 and accompanying text.

<sup>226</sup> Draft operating agreement, para 6.4 (u.d.) (unpublished operating agreement) (on file with the Utah Law Review).

<sup>227</sup> Draft operating agreement, para. 3.6(a) (u.d.) (unpublished operating agreement) (on file with the Utah Law Review).

These differences result in increased reading costs for participants.<sup>228</sup> It would take a careful reading even for those with prior business experience to discern that, in each case, a member is allowed to do business with the company, an obvious conflict of interest, so long as the other members are aware of the conflict and the terms are objectively fair to the company. An even closer read might identify the slight differences between the provisions in applicability to affiliates of members and definitions of fairness. Thus, the language variations can obscure the underlying choices that were made in forming the organization.<sup>229</sup>

Consistent language facilitates inclusion by making the review process more meaningful and encourages better discussion among the parties and attorneys.<sup>230</sup> It reduces the burden on investors to determine their rights and obligations, and it highlights the bargaining points in the same way that state realtors association form documents streamline the negotiating points for common property acquisitions.<sup>231</sup> Thus, uniform provisions create and utilize terms of art such that the language conveys the underlying agreement immediately, which reduces asymmetry of information. Moreover, it accommodates faster and more cost-effective outside review by counsel to each of the individual members or by other interested parties. In this way the negotiation process becomes less insular, and more participants have the requisite commitment and attachment to the document and the organization.<sup>232</sup>

Standardization also allows the document to be more specific and comprehensive in terms of the scope and detail of issues it covers.<sup>233</sup> With less opaque language, the document can address more issues and address them more efficiently. Uniform language in turn allows for conversations and decisions covering more topics by enhancing participation in the negotiating process.<sup>234</sup> Bargaining becomes easier and less costly with language that is standardized, which

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<sup>228</sup> Davis, *supra* note 49, at 100 (“[T]he magnitude of reading costs . . . depends on how much the document and the associated contract deviate—in terms of both language and substance—from documents with which the reader is already familiar.”).

<sup>229</sup> Stein, *supra* note 68, at 66 (“By cutting away some of the less important verbiage, attorneys can help the parties (and potentially the courts) focus on the fundamentals and get them right.”).

<sup>230</sup> See *supra* notes 198–199 and accompanying text.

<sup>231</sup> Davis, *supra* note 49, at 100–01 (“[T]he value of adopting a given contractual document will increase to the extent that it either is already familiar to potential readers or is expected to become familiar to such readers while it is in use. In other words, the value of a document will depend on how frequently it has been used in the past and how widely it will be used while in force.”).

<sup>232</sup> See *supra* note 203 and accompanying text.

<sup>233</sup> See *supra* Part IV.B.3; see also Smith, *supra* note 52, at 1188 (“Boilerplate exploits modularity, and this modularity in turn allows for a greater degree of complexity and specialization than would be possible otherwise. . . . As artifacts—including contracts and other legal relations—become more complex, more specialization is called for—specialization that modularity can support through its role in managing complexity.”).

<sup>234</sup> See Dent, *supra* note 76, at 311 (“One way to preserve trust is to avoid unusual and complex terms. The effects of novel terms are hard to predict; business people feel more comfortable with customary terms.”).



can accommodate increased specificity in the document.

Other benefits flow from the use of similar provisions. Among the most significant benefits is consistency of interpretation by courts.<sup>235</sup> Courts outside of a select few jurisdictions like New York, Delaware, or California are infrequently confronted with these types of organizational document interpretation issues.<sup>236</sup> States with a paucity of business law could easily look to these states for interpretive guidance if the language used in private agreements is similar.

The idea is not to transform organizational attorneys into scribes who merely engage in check-the-box practice. More standardized language is not meant to be unalterable. It merely serves as a starting point and highlights the differences between documents so readers can more readily identify the unique choices made in a particular structure.

Even in a more uniform drafting setting, conscientious drafters still reap benefits. Although law firms can be proprietary in the content and style of their form documents, they can nonetheless retain their competitive advantage even with standardized language because it will allow them to better serve their clients and facilitate easier comparison of competing documents.<sup>237</sup>

### C. *Beyond Traditional Document Usage*

Finally, attorneys can maximize the effectiveness of business organizational documents by considering other uses of technology that can enhance the functionality of documents. Nearly all documents now exist electronically, and even the simplest word processing software has capacities far greater than those typically used by attorneys.<sup>238</sup> Organizational document drafters have thus far been reluctant to take advantage of technological tools that have developed over the last decades, much less the last few years.<sup>239</sup> Presently, a “modern” operating agreement is one

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<sup>235</sup> Goetz & Scott, *supra* note 220, at 301 (“An important goal of the drafter of any contractual formulation is to create a contract that a court will interpret in a predictable way.”).

<sup>236</sup> See Miller, *supra* note 100, at 351, 357 (noting that of survey respondents from Delaware, California, New York, and Pennsylvania, those from Delaware reported a higher level of experience with shareholder lawsuits).

<sup>237</sup> See Cunningham, *supra* note 3, at 353 (“But for many contract terms—certainly maturely standardized terms . . . —the real premium arises from efficiency (achieving client objectives cheaply and swiftly) not drafting expertise designed to achieve substantively favorable or superior terms.” (citation omitted)); see also Patterson, *supra* note 48, at 333 (“Multifirm contract standardization can provide . . . increased competition among firms, because a standard contract makes comparison among firms’ offerings easier.”).

<sup>238</sup> See Cunningham, *supra* note 3, at 315 (discussing how attorneys typically create and store forms and precedent documents electronically).

<sup>239</sup> *Id.* at 370–71 (“As an example, before 1980, litigators ascertained whether judicial precedents were good law using printed books of case histories. When such information became digitized and accessible using office terminals, newly trained lawyers embraced the system and comfortably relied upon it while veteran lawyers expressed skepticism about whether the computer had it right. No well known stories of failure have appeared.”).

that allows for email notices or provides for telephonic meetings.

Drafting attorneys could consider more dynamic document structures and features that would facilitate inclusion, specificity, and flexibility. Technological advances can allow attorneys to create documents that are more user-friendly to a wider audience of clients, facilitate deeper discussion of the key terms and their implications, and thus enhance the bargaining and drafting process. Organizational documents could contain links to spreadsheets where parties and attorneys can easily adjust ownership percentages, capital accounts, allocations of income or loss items, or other terms in the agreement. Modifying allocation percentages obviously carries the potential for significant tax consequences,<sup>240</sup> so although a more modern operating agreement may facilitate the easy alteration of these provisions, it should also incorporate safeguards that identify potentially adverse impacts of changes and flag other provisions in the agreement that might need to be reconsidered or modified consistent with the change.

Organizational documents could also easily include forms for required notices for meetings of the members or of a member's intent to transfer a portion of her ownership, giving rise to a right of first refusal to other members and the company. These documents could simply be hyperlinked throughout the document where the notices are referenced or incorporated into the standard notification provision, along with email addresses.<sup>241</sup> It would also be possible for these more dynamic documents to interface with other programs, such as a web-based email program that could provide calendar reminders for annual meetings or for required distributions (e.g., for estimated tax liability).

Finally, one could rethink the look and layout of organizational documents. Particularly when standardized provisions are used, attorneys could easily provide summary or graphic tools that help explain the content of the underlying organizational document in a concise and readable fashion. Operating agreements tend to be dense and complex, often longer than law review articles, which is not to say that they are not good documents. They are fairly comprehensive, organized in a sensible manner, and address major deal points and most possible legal contingencies. But they are not very usable for the client or effective in communicating the rights and obligations of the parties. Further, documents could be designed to be more compatible for digital readers and for documents read on computers, again with the enhanced functionality and technical capabilities such as hyperlinks or incorporation of Excel sheets, graphs, and charts.

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<sup>240</sup> See LAURA E. CUNNINGHAM & NOËL B. CUNNINGHAM, *THE LOGIC OF SUBCHAPTER K: A CONCEPTUAL GUIDE TO TAXATION OF PARTNERSHIPS* 51 (4th ed. 2011) (discussing how allocations generally must either have substantial economic effect or be in accordance with the partner's interest in the partnership or risk being reallocated in accordance with such interest as described in Treas. Reg. § 1.704-1(b)(3) (2014)).

<sup>241</sup> Davis, *supra* note 49, at 103–04 (“For example, embedding XML codes in contractual documents can make it easy for individual terms to be searched for and linked to texts that explain their import, even as they are cut and pasted from one document to another.”).

All of these features speak to the document as a tool for the members of the organization, as opposed to merely a guide for attorneys to address conflicts after they have arisen or in preparation for litigation. More advanced documents can promote inclusion and specificity not only at the drafting phase but also in the ongoing operations of the organization. When it is easier for the clients to understand the nature of the agreement (tabular summary layout), to comply with their obligations (prepopulated notice forms connected to email programs), and to see the consequences of various actions (Excel sheets that easily display modifications to allocations and distributions), the bargaining and operating processes are inherently more inclusive and can be more flexible and more specific.

## VI. CONCLUSION

Design choices matter. Whether the institution is a constitution or a business structure, the elections reflected in the document and the process by which those elections were made can impact the likelihood of success of the enterprise. Knowing how design choices such as endurance affect certain aspects of institutional success allows organizers to make more informed and reliable decisions about how to structure their enterprises for themselves and for their investors.

Organizational drafting for business entities is often an unmoored process, resulting in structures that fail to take into account unique objectives of founders. Business and transactional attorneys who embrace a more deliberate approach to entity design can provide more appropriate products for their clients. This Article suggests that business lawyers look to the lessons from constitutional design literature and the elements associated with enduring institutions—inclusion, flexibility, specificity—for guidance in developing more thorough bargaining and drafting processes. Even when a long-lived structure is not a paramount goal of the organizers, understanding how such design choices impact endurance and the bargain in general can help attorneys match the organizational structure to the founders' goals.