**The Optional Firm**

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*Abstract*

*Venture-backed startups depart from traditional corporate models by allocating equity through a layered structure of common stock, multiple series of preferred stock, and convertible instruments such as options and warrants. The result is a fragmented residual claim shared among founders, investors, employees, and strategic partners. In particular, rather than compensating employees through fixed salaries alone, startups provide equity grants that entitle them to share in the firm’s financial gains only if the venture succeeds.*

*What may appear to be a technical feature of venture finance reflects a more profound transformation in firm architecture. In intangible-intensive enterprises, where core assets such as human capital, proprietary code, and brand reputation are challenging to contractually secure, equity instruments become the principal mechanism for aligning incentives and mitigating spillover risks. This arrangement allows the startup to function as an optional firm: a flexible coalition of contributors who can withdraw their contributions at will but remain engaged so long as the prospect of future value offsets their opportunity costs.*

*This Article develops the concept of contingent shared ownership as a foundational framework for ownership in firms built around intangible assets. By doing so, it synthesizes the two leading theories of the firm—principal-agent and team production—to describe why control remains concentrated while financial returns are distributed across a broad coalition of stakeholders. The Article further argues that this framework offers a more coherent account of Delaware fiduciary doctrine in venture-backed companies, known as the Trados doctrine, than either of these theories provides on its own. In this context, the duty to maximize common stock value functions, whether by design or effect, as a mechanism for protecting the firm’s human capital.*

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*“The Silicon Valley attitude is: We’re asking people to go on an adventure with us. If we find a treasure, everyone deserves a piece.”*[[1]](#footnote-1)

# Introduction

Venture-backed startups depart from the conventional corporate model by allocating both fixed and residual claims across a diverse group of stakeholders. Venture capital investors typically receive convertible preferred shares, which entitle them to liquidation preferences (fixed claims), participation in the upside (residual claims), or both.[[2]](#footnote-2) Founders usually hold common stock (residual claims), draw salaries once capital is raised, and may also receive additional incentives such as bonuses or options.[[3]](#footnote-3) Employees are compensated through a mix of salaries (fixed claims) and stock options or restricted stock units (RSUs), which give them the right to share in the firm’s residual value if it succeeds.[[4]](#footnote-4) Some startups even offer stock options to suppliers or customers, likewise rewarding them with the potential to share in future gains. In effect, ownership is distributed among various contributors, contingent on the firm’s success.[[5]](#footnote-5)

The implicit contract underlying this structure is straightforward: if the firm fails, preferred shareholders recover what remains,[[6]](#footnote-6) and if it succeeds, the gains are shared across a wide spectrum of contributors.[[7]](#footnote-7) In this Article, this distinctive ownership arrangement is referred to as *contingent shared ownership*. The economic rights are *shared* in the sense that multiple contributors hold claims to the firm’s upside, and *contingent* in that those claims materialize only if the firm succeeds.

Venture capital scholars have long recognized the importance of *contingent control*, the strategic allocation of governance rights based on firm performance, as a defining feature of startup finance.[[8]](#footnote-8) The literature has traced how control shifts between founders and investors to manage agency costs and preserve value when ventures falter. But its focus has remained largely on the downside: how control rights are used to safeguard investor interests in failure scenarios through board representation, veto powers, and liquidation preferences.

This emphasis on the downside, however, has become increasingly incomplete. In today’s founder-friendly governance environment, formal control mechanisms are often diluted or waived altogether.[[9]](#footnote-9) More importantly, by focusing on *downside control*, the existing framework has largely overlooked the broad allocation of *upside economic value*, which is the more consequential dimension in a market characterized by a power-law distribution of investment returns, where a handful of outlier successes compensate for the many that fail.[[10]](#footnote-10)

This Article makes two contributions to the literature. First, it introduces the concept of *contingent shared ownership* to explain how startups integrate financial and human capital through options and other convertible equity instruments. It situates this ownership pattern within the broader economic shift toward intangible assets and argues that this shift enables a synthesis of two foundational frameworks in corporate theory—principal-agent and team production—to address the unique governance challenges of human-capital-intensive enterprises. Second, the Article demonstrates that the contingent shared ownership framework provides a more coherent and analytically persuasive account of Delaware’s *Trados* doctrine (which holds that directors must prioritize common shareholders’ interests when the firm faces a conflict between common and preferred stockholders)[[11]](#footnote-11) than the existing theoretical models.

A refined understanding of contingent shared ownership is increasingly warranted, as this ownership model is no longer confined to Silicon Valley but is gaining traction globally across jurisdictions in Europe and Asia and extending into adjacent industries such as private equity.[[12]](#footnote-12) Its growing adoption reflects a broader shift in the economy toward intangible asset-intensive enterprises, where value creation depends less on physical capital and more on human capital, code, data, brand, and network effects.[[13]](#footnote-13) In such firms, equity-based alignment mechanisms become essential to ensure the continued participation of key contributors whose tacit knowledge and discretionary effort are both central to the firm’s trajectory and fundamentally non-contractible.[[14]](#footnote-14)

Existing corporate governance theories have proven inadequate to account for venture-backed startups, as neither the principal-agent nor the team production models captures their unique structural complexities.[[15]](#footnote-15) The principal-agent model assumes clear divisions between principals (investors) and agents (managers),[[16]](#footnote-16) but startups disrupt this clarity due to overlapping roles and fluid control arrangements.[[17]](#footnote-17) Similarly, while the team production model captures important aspects of collaborative value creation,[[18]](#footnote-18) it does not fully capture the dynamic equity structures and hybrid claims that characterize startup ownership.[[19]](#footnote-19) Robert Bartlett’s dynamic agency cost model advanced the field by showing that startups are shaped by both vertical and horizontal agency conflicts, thereby challenging the conventional dichotomy that associates vertical conflicts with public firms governance and horizontal conflicts with private firm governance.[[20]](#footnote-20) Elizabeth Pollman deepened this insight by mapping how these governance tensions evolve over the startup lifecycle and highlighting the overlapping roles played by founders, investors, and employees.[[21]](#footnote-21) Building on these insights, this Article suggests that contingent shared ownership helps resolve the incentive and coordination challenges at the heart of both theoretical models.

Contingent shared ownership synthesizes principal-agent and team production theories to explain how startups allocate fixed and residual claims to align the incentives of diverse contributors under conditions of at-will collaboration, non-contractible contributions, and high opportunity costs. This Article argues that fixed claims offer downside protection for firm-specific investments, addressing the sunk-cost attribute of intangible assets.[[22]](#footnote-22) By contrast, residual claims provide the upside potential needed to offset the parties’ opportunity costs and sustain discretionary effort, thereby containing the risk of knowledge spillover.[[23]](#footnote-23) Corporate law reflects this logic: fiduciary duties run only to equity holders,[[24]](#footnote-24) and when conflicts arise, Delaware prioritizes the residual claim.[[25]](#footnote-25)

Under the *Trados* doctrine, when the interests of common and preferred shareholders diverge, the board is required to act in the interests of common shareholders.[[26]](#footnote-26) The enhanced rights of preferred shareholders are treated as contractual and do not receive special protection under corporate law.[[27]](#footnote-27) This principle is difficult to reconcile with the principal-agent framework, leading some scholars to argue that Delaware’s Court of Chancery reached the wrong result.[[28]](#footnote-28) Blair and Stout’s team production theory fares no better, as its vision of the board as a neutral mediating authority is difficult to reconcile with a doctrine that explicitly prioritizes certain constituents over others.[[29]](#footnote-29) By contrast, the *Trados* doctrine aligns with the logic of contingent shared ownership. In startups, common stock is typically held by founders and employees, and prioritizing the interests of common shareholders reflects the firm’s foundational bargain: sharing in the residual claim serves as compensation for sustained, high-risk collaboration. Under this framework, the board’s duty to maximize common stock value does not imply the rejection of stakeholder interests but instead provides the mechanism through which they are secured. The conventional dichotomy between shareholder primacy and stakeholder governance fails to capture the dynamics of this growing sector of the economy, where maximizing residual value is precisely what sustains the production team.

The Article proceeds as follows. **Part I** examines the inputs to startup formation.It analyzes venture capital as a distinct asset class suited to intangible-intensive firms, exploring staging, convertible securities, and the shift to founder-friendly governance. It then turns to human capital, covering founders, employees, and other stakeholders such as strategic partners, lenders, and platform users. It focuses on how equity-based instruments align these diverse stakeholders whose voluntary participation is essential to firm success. **Part II** introduces and develops the concept of contingent shared ownership, an ownership architecture in which residual claims are conditionally distributed among various stakeholders to sustain ongoing collaboration. This Part explains how startup capital structures integrate financial and human capital and examines how proceeds are allocated upon exit. **Part III** situates this theory within the broader literature. It evaluates the principal-agent and team production models, showing why each fails to fully capture the dynamics of startup ownership. It argues that contingent shared ownership synthesizes insights from both while addressing their core limitations. **Part IV** applies the theory to corporate law doctrine. It argues that contingent shared ownership provides a more coherent and analytically satisfying explanation of the Delaware Court of Chancery’s *Trados* doctrine than existing theoretical approaches. The Article concludes by exploring the broader implications of this model for corporate law and governance, as the contingent shared ownership model gains traction beyond the startup context and across global markets.

# I: The Inputs That Power the Optional Firm

Startups are not miniature versions of large corporations.[[30]](#footnote-30) They are firms with a limited revenue history that focus intensively on research and development (R&D) while pursuing rapid growth through technological or other innovations that provide competitive advantages.[[31]](#footnote-31) This Part examines how financial and human capital are deployed toward this goal and how their interaction creates a distinctive ownership architecture that characterizes venture-backed startups.

## Venture Capital

To understand why venture capital emerged as the dominant financing source for startups, we must first examine the structural mismatch between intangible-intensive firms and traditional sources of capital.

### Filling the Financing Void for Intangible Firms

Startups are quintessential intangible-intensive firms; their core assets are not factories or inventory, but rather ideas, code, data, brand, and, most importantly, people.[[32]](#footnote-32) Intangible assets have four defining characteristics, sometimes referred to as the “four Ss”: *sunkenness*, *spillovers*, *scalability*, and *synergies*. Each of these characteristics compounds the difficulty of financing intangible-intensive enterprises through traditional means.[[33]](#footnote-33) *Sunkenness*: Investments in R&D, design, or brand are typically non-recoverable if a venture fails because they create assets with little or no liquidation value that cannot easily be transferred, resold, or used to satisfy creditors.[[34]](#footnote-34) *Spillovers*: The knowledge that these investments produce is often embedded in individuals or organizational routines and is subject to leakage through employee mobility or imitation, further diminishing the ability to capture the return on the investment.[[35]](#footnote-35) *Scalability:* Once created, intangible assets can be deployed at almost zero marginal cost, enabling rapid growth, but this upside makes early valuation tricky as small initial investments may suddenly yield explosive, unpredictable returns.[[36]](#footnote-36) *Synergies*: Intangibles often derive value from being combined; for example, data may enhance code, or brand may reinforce design. This interdependence, however, makes it difficult to assess the value of each component on a standalone basis.[[37]](#footnote-37)

These four features of intangible assets lead to distinctive return patterns that follow a power-law distribution.[[38]](#footnote-38) Unlike traditional investments, whose outcomes cluster around a mean, returns on intangible-intensive enterprises are highly skewed: most ventures fail or generate only modest gains, while a select few deliver exceptional returns that far outweigh the losses or modest gains of the others.[[39]](#footnote-39) This asymmetry is rooted in the nature of investment in intangible assets: failures often result in total loss, as intangible assets typically offer little to no liquidation value (sunkenness). At the same time, spillovers may make it difficult for firms to fully capture the benefits of their innovations. By contrast, ventures that succeed in leveraging scalability and synergies can experience rapid, exponential growth, vastly outperforming conventional expectations.[[40]](#footnote-40)

The result is a valuation environment characterized by high uncertainty and asymmetric outcomes. This environment is a poor match for conventional financial tools.[[41]](#footnote-41) Debt markets, in particular, remain ill-suited to financing firms that cannot offer hard collateral or predictable income streams, and banks are structurally constrained to lend against assets they can reliably value, seize, and liquidate in the event of default.[[42]](#footnote-42) Without inventory, receivables, or physical property to pledge, startups fall outside the underwriting models of conventional lenders. Public equity markets may not provide a better alternative, as intangible assets resist standardized valuation and cannot be easily conveyed through quarterly financial disclosures.[[43]](#footnote-43) As a result, even mature firms built on intangible foundations may struggle to access capital through conventional channels, where investors rely on comparable metrics and tangible benchmarks.[[44]](#footnote-44)

This financing gap created the conditions for venture capital’s emergence.[[45]](#footnote-45) The following sections trace how venture capital evolved specifically to fill this gap by examining the distinctive legal and organizational features that render venture capital funds especially well-suited for investing in intangible-intensive enterprises that require patient, risk-tolerant, and informed capital.

### Patient Capital by Design

Venture capital funds are commonly structured as limited partnerships with a finite lifespan, typically ten to twelve years, with the possibility of potential extensions.[[46]](#footnote-46) Within this structure, outside investors (limited partners, or LPs – e.g., pension funds, endowments, and wealthy individuals) commit capital up front to a fund managed by professional venture capitalists as general partners (GPs). Like shareholders in a corporation, LPs enjoy limited liability: they are not personally responsible for the fund’s obligations beyond their committed capital.[[47]](#footnote-47) But unlike shareholders, LPs exercise virtually no governance rights over the fund’s operations or investment decisions.[[48]](#footnote-48) The fund is managed entirely by the GPs in accordance with the limited partnership agreement (LPA), a contractually negotiated and privately ordered arrangement that governs all aspects of fund management, economics, and fiduciary duties.[[49]](#footnote-49)

Traditionally, these funds have taken the form of closed-end partnerships: capital commitments are locked in, and LPs cannot demand withdrawals, early redemptions, or freely transfer their interests.[[50]](#footnote-50) Funds typically deploy committed capital into new investments over the first few years, then use the remainder of the term to nurture these investments and eventually exit them.[[51]](#footnote-51) Each fund’s illiquidity shields it from short-term market pressures, which, together with the legal structure described above, enables GPs to operate with considerable discretion and little constraint in the pursuit of high-risk, long-term, unconventional investments.[[52]](#footnote-52) At the same time, the fund’s finite lifespan imposes a deadline that sharpens incentives and aligns managers’ interests with those of their investors.[[53]](#footnote-53)

GPs are incentivized to prioritize the fund’s long-term performance through a compensation structure that includes a management fee (typically 2% of committed capital annually) and carried interest (commonly 20% of the fund’s profits), with the latter generally distributed only after LPs have received their initial capital contributions plus, in some cases, a preferred return.[[54]](#footnote-54) In addition, GPs frequently invest their own capital in the fund (commonly 1–2% of total commitments), ensuring they have “skin in the game” and share in both the risks and rewards of the fund’s outcomes.[[55]](#footnote-55)

In sum, the limited partnership model establishes a governance framework defined by patient capital, limited investor intervention, and strong performance-based incentives. While this structure effectively addresses the challenges of funding horizon and incentive alignment, it does not resolve a more fundamental problem: how to structure investment relationships in startups with few tangible assets and uncertain cash flows. Venture capital meets this challenge through a distinctive set of interlocking contractual mechanisms, discussed below.

### Embedded Optionality through Staging and Convertible Securities

To address the extreme uncertainty and substantial information asymmetries in their investments, venture capital contracts are structured to allocate capital incrementally. Venture capitalists employ adaptive mechanisms, such as milestone-based funding, to condition subsequent investments on observable performance metrics and maintain flexibility in allocating cash flow rights, often through convertible securities, based on the company’s valuation at the time of a liquidity event, such as an IPO or acquisition.

A defining feature of venture capital is *staged financing*: rather than committing capital upfront, investors deploy funds in successive rounds, each contingent on the company meeting specific milestones, such as prototype development, user growth, or early revenues.[[56]](#footnote-56) Structurally, each round functions like a *real option*, giving investors the right, but not the obligation, to commit further capital as new information emerges and progress becomes verifiable.[[57]](#footnote-57) This staged approach creates mutual benefits for both parties. For investors, it mitigates downside risk by limiting exposure to underperforming ventures while disciplining founders to achieve concrete results before accessing additional funding.[[58]](#footnote-58) For founders, staging serves their interests by allowing them to raise modest sums early on, thereby avoiding significant dilution when risk is high and capital is expensive.[[59]](#footnote-59) As the venture proves itself over time, subsequent rounds are priced at higher valuations, enabling founders to preserve greater ownership and align equity outcomes with real value creation. This structure follows naturally from the economics of financing intangible-intensive enterprises: because returns are power-law distributed, with most startups failing while a few generate outsized gains, capital flows disproportionately through successive rounds to the rare winners rather than being spread evenly across all investments.

Staging is complemented by the use of convertible preferred stock, a hybrid security that combines two distinct features: preference and convertibility. As *preferred* stock, it grants holders (investors) priority over common shareholders in adverse scenarios, most notably through liquidation preferences, which are contractual rights establishing that, upon liquidation and after creditors are paid, investors recover their invested capital (and sometimes an additional return) before any proceeds flow to other shareholders. As *convertible* stock, it gives investors the option, in favorable scenarios, to convert their preferred shares into common shares, typically on a one-to-one basis, enabling them to participate fully in the venture’s upside. This dual structure embeds optionality into the security as it functions like debt in downside scenarios and like equity in upside scenarios.[[60]](#footnote-60) The specific terms of the convertible preferred stock—*liquidation preferences*,[[61]](#footnote-61) *conversion ratios*,[[62]](#footnote-62) *participation rights*,[[63]](#footnote-63) and *anti-dilution protections[[64]](#footnote-64)*—are negotiated between the founders and investors and often vary across financing rounds. These provisions define how economic rights are allocated under different outcomes and play a central role in structuring financial incentives across the venture’s lifecycle.

In summary, venture capital employs staged financing and convertible preferred stock to manage the extreme uncertainty of intangible-intensive startups, with staging functioning as a real option for incremental capital deployment and convertible securities embedding optionality through liquidation preferences and conversion rights. Not only is the allocation of cash flow rights contingent on performance and outcomes, but control rights are equally contingent, with governance authority shifting among equity holders as described in the following section.

### From Contingent Control to Founder‑Centric Governance

Unlike traditional corporations, where control rights are typically fixed and proportional to ownership, venture-backed startups distribute decision-making authority based on observable milestones, performance metrics, and the evolving risk profile of the enterprise.[[65]](#footnote-65) This section begins by outlining the conventional theory of *contingent control*—a model designed to reallocate authority from founders to investors when performance falters, thereby protecting capital in high-uncertainty environments. It then turns to the emergence of *founder-friendly* governance, where investors forgo formal control, even amid underperformance, in pursuit of outsized returns from rare, transformative companies.

The conventional theory of contingent control, grounded in the literature on incomplete contracts and debt governance, rests on the core insight that founders should lead when the venture performs well, but investors must hold contractual rights to intervene when performance deteriorates.[[66]](#footnote-66) This mirrors the logic of debt contracts, where creditors gain control rights upon borrower default. In early-stage, intangible-heavy startups, agency problems loom large and information asymmetries and moral hazards expose investors to significant downside risk.[[67]](#footnote-67) Founders often possess superior information and may pursue private benefits or resist value-maximizing changes, making traditional governance tools inadequate.[[68]](#footnote-68) To address this, venture capital contracts embed control rights that activate upon predefined performance failures, such as missed milestones, delayed timelines, or down-round financings (when the company issues new shares at a lower price than that paid by earlier investors).[[69]](#footnote-69) These ex ante triggers are designed to mitigate renegotiation frictions and hold-up risks, allowing investors to assert control when the venture’s trajectory becomes uncertain.[[70]](#footnote-70)

Contingent control is implemented through a suite of contractual mechanisms that allow governance rights to shift over time, based on observable performance. The primary vehicle is *board composition*: term sheets and shareholder agreements frequently specify that investors will gain additional board seats upon the occurrence of defined triggers, such as missing revenue milestones, failing to raise capital at a target valuation, or entering a down-round.[[71]](#footnote-71) These provisions are drafted ex ante to avoid renegotiation during crises, enabling a pre-agreed reallocation of control when investor capital becomes more exposed. *Protective provisions* further embed negative control by granting investors class-specific veto rights over key decisions, which are activated not by poor performance per se, but by certain major transactions and changes, such as issuing new shares, taking on debt, or altering governance structures.[[72]](#footnote-72) In addition, the capital structure itself can be engineered to reflect contingent authority: preferred shares often carry *enhanced voting rights* or *supermajority thresholds* that effectively transfer control to investors under predefined circumstances. *Redemption rights* create time-based contingencies by giving investors the contractual power to force a liquidity event if no exit has occurred by a fixed deadline. Finally, exit-related terms such as *drag-along* and *registration rights* ensure that, even where founders remain formally in control, investors can compel an exit once certain thresholds are met. Together, these mechanisms form a layered governance framework that does not merely reflect current ownership but anticipates and responds to the evolving risk environment of high-growth, intangible-intensive enterprises.

Yet this conventional model no longer fully describes the prevailing equilibrium in venture capital. In recent years, deal structures have become increasingly founder-friendly, with investors ceding board control, waiving veto rights, and foregoing standard enforcement tools, even when performance lags.[[73]](#footnote-73) At first glance, this appears to undermine the logic of contingent governance. In fact, however, it reflects a reapplication of the same underlying economics. Startups remain intangible-intensive and subject to radical uncertainty, and venture returns remain power-law distributed. In this environment, the marginal value of retaining access to a potential outlier, the rare company that will provide a positive return to the fund, can justify conceding formal control to the founder, even at the cost of weaker oversight. As Peter Thiel, Ken Howery, and Luke Nosek put it, in articulating the Founders Fund ethos, the firm would “never remove entrepreneurs from their own companies”—a strategic choice rooted not in neglect, but in the conviction that preserving founder agency maximizes the chances of capturing extraordinary upside.[[74]](#footnote-74) This shift reconfigures contingent control: rather than enforcing discipline through ex ante mechanisms, some venture firms compete by offering founders autonomy, speed, and loyalty, betting that access to exceptional founders trumps governance risk, and reflecting the power-law logic that rewards tolerating volatility to secure rare, high-impact outcomes.

This rebalancing of formal control rights between investors and founders reflects a deeper structural reality: in intangible-intensive firms, attracting and retaining exceptional human capital has become increasingly critical to value creation. The following sections describe how equity instruments help address the challenge of aligning diverse stakeholders whose voluntary participation remains essential to firm success.

## Human Capital

If venture capital provides a financial scaffold for the entrepreneurial firm, human capital is its animating force. In startups, the capacity to attract, motivate, and retain skilled workers is the firm’s core challenge, often more critical than attracting capital itself.[[75]](#footnote-75) Unlike financial capital, however, human capital cannot be locked in by contract; it can walk out the door and cannot credibly commit to staying,[[76]](#footnote-76) especially in California, where post-employment non-compete agreements are unenforceable.[[77]](#footnote-77) The following sections describe the unique attributes of human capital and then examine how startups align the interests of founders and employees with those of investors.

### Human Capital Hold-Up and Knowledge Spillovers

The term “human capital” was coined in the 1960s by Nobel laureate in economics, Gary Becker, and refers to the knowledge, skills, and abilities of individuals that enhance their productivity and economic value.[[78]](#footnote-78) Human capital can be increased through investment, for example, through professional training or education.[[79]](#footnote-79) Becker distinguished between two types of human capital: firm-specific and general.[[80]](#footnote-80) Firm-specific human capital benefits only one company; consequently, individuals do not receive higher wages for it in the broader job market. For example, mastering an internal programming language used exclusively by one company has no value to other employers. By contrast, general human capital benefits many companies and is therefore rewarded with higher wages. Mastering a widely used programming language, for instance, makes an individual valuable across the entire job market.

Economic theory predicts that employers will underinvest in general human capital.[[81]](#footnote-81) The logic is straightforward: firm-specific training benefits employers because it increases productivity without creating flight risk, but general human capital works differently. When employers invest in general skills, they enhance their employees’ value to other companies as well.[[82]](#footnote-82) This creates a hold-up problem as once employees receive training that makes them more valuable across the job market, they can demand higher wages that capture this increased productivity.[[83]](#footnote-83) Employers know that if they refuse, these newly skilled workers can easily find better opportunities with competitors.

This dilemma intensifies in R&D-intensive sectors where know-how, design expertise, and tacit knowledge are embodied in people. Unlike patentable inventions, much of this knowledge resists formal protection and instead diffuses through employee movement.[[84]](#footnote-84) This leads to spillover risk: the very act of training employees or enabling their access to organizational knowledge may cause the firm’s competitive advantage to leak to competitors if employees depart. As a result, the firm that bears the cost of knowledge creation may not capture the full value of its returns.

Yet spillovers are not merely a threat: they are also the engine that drives innovation clusters. Modern growth theory, particularly in the endogenous models of Romer and others, recharacterizes technological leakage as a generative externality.[[85]](#footnote-85) Silicon Valley did not flourish despite the porous boundaries between firms: it flourished because of them.[[86]](#footnote-86) As employees moved freely, ideas cross-pollinated.[[87]](#footnote-87) The diffusion of knowledge raised the collective competence of the region, even as individual firms grappled with retention and imitation. Seen in this way, the dual nature of spillovers, value-destroying for the firm and value-creating for the ecosystem, is central to the paradox of innovation.[[88]](#footnote-88)

California’s legal framework institutionalized this paradox. By refusing to enforce non-compete agreements, the state prioritized labor mobility and regional innovation over firm-level protectionism. This legal posture created systemic exposure to talent leakage but also catalyzed an organizational response.[[89]](#footnote-89) Since firms could not rely on legal constraints to retain talent, they developed equity-based mechanisms to align incentives.[[90]](#footnote-90) As discussed in the following sections, stock options, RSUs, and founder reverse vesting schedules became standard tools, not just to motivate performance but also to anchor human capital to the venture itself.[[91]](#footnote-91)

In sum, human capital in venture-backed startups is not merely an input; it is the core asset of the firm. The risk of appropriation, the inevitability of spillovers, and the prohibition on non-competes have forced these firms, and the venture capital industry at large, to develop contingent ownership structures that internalize externalities and transform employees into equity holders.[[92]](#footnote-92)

### Harnessing Founder Commitment

The economic architecture of venture-backed startups is designed to address a core challenge in startup finance: how to ensure that founders, who possess both the specialized human capital and entrepreneurial vision essential to the venture’s success, remain fully committed to the firm’s long-term development rather than pursuing individual interests that may diverge from collective value creation.

In technology-driven enterprises, value creation often stems from pursuing novel ideas that challenge industry norms.[[93]](#footnote-93) Founders embrace contrarian thinking not despite its divergence from consensus but because it drives advantage during technological transformation.[[94]](#footnote-94) Incumbent firms, tethered to existing structures, incentives, and customers, often fail to adapt.[[95]](#footnote-95) Founders’ defiance, impatience, and nonconformity (the very traits that clash with traditional organizations) are not flaws but strengths, enabling them to envision and create new products and services beyond the conventional horizon.[[96]](#footnote-96) However, founders face substantial risks, including time, reputation, and personal capital, while stepping outside conventional paths to pursue uncertain ideas, creating pressure that might lead them to abandon these ventures before they reach fruition. This creates the core challenge: harnessing these valuable contrarian qualities while ensuring sustained commitment to the collective enterprise.

The commitment problem begins at incorporation, when founders typically control the venture’s foundational intellectual property: the code, inventions, and designs developed during the pre-incorporation phase. To prevent future value fragmentation, founders sign IP assignment agreements that transfer all intellectual property rights to the corporate entity in exchange for equity stakes in the new venture.[[97]](#footnote-97) This transfer leverages what economists term “asset complementarity” between founder human capital and the IP: the founder’s specialized knowledge becomes most valuable when deployed in conjunction with the firm’s intellectual property assets, while its value diminishes significantly outside the firm where such access is unavailable.[[98]](#footnote-98) By consolidating both the human capital and complementary IP assets within the corporate structure, this arrangement exploits pre-existing synergies to create structural dependency that serves as an initial commitment device.

However, ownership alone is not enough to ensure sustained commitment. Despite initially controlling all or nearly all equity, founders are typically expected to subject their shares to “reverse vesting” schedules coupled with company repurchase rights.[[99]](#footnote-99) Under these arrangements, founders’ equity vests incrementally over a period of several years, with a cliff typically after one year, allowing the company to reclaim unvested shares at nominal consideration or no consideration at all if a founder departs prematurely.[[100]](#footnote-100) This mechanism directly addresses the “dead equity” problem: the retention of significant ownership by individuals who are no longer contributing to firm development.[[101]](#footnote-101) Dead equity creates multiple inefficiencies. It generates free-rider problems that undermine the motivation of the remaining team members, reduces the equity pool available for talent acquisition and future investment rounds, and may vest governance or information rights in departed founders who have become disconnected from, and possibly antagonistic toward, the company’s strategic direction.

The transition to venture capital funding introduces additional layers of commitment mechanisms designed to lock in founder human capital while providing appropriate growth incentives. Venture capitalists construct these mechanisms around two core principles: protecting founder upside exposure and preventing premature exit.

First, venture capitalists preserve the substantial equity stakes held by founders, typically in common stock, rather than heavily diluting their ownership positions.[[102]](#footnote-102) This structure ties founders’ financial rewards to the company’s growth, while venture capitalists hold convertible preferred stock to safeguard their investment.[[103]](#footnote-103) The resulting capital structure encourages founders to pursue strategies that enhance enterprise value, aligning their interests with those of the investors.

Second, robust *transfer restrictions* prevent founders from selling their equity without investor consent. These include board approval requirements for any share transfers, rights of first refusal (ROFR) requiring founders to offer shares to the company or existing investors before selling to third parties, and tag-along provisions that allow minority shareholders to join a founder-initiated sale.[[104]](#footnote-104) Together, these contractual constraints function as commitment devices, channeling founder exit decisions through collective investor approval processes.

In practice, founders typically retain 10–20% of the equity at the time of an exit.[[105]](#footnote-105) This ownership level often does not suffice to preserve control. This tension has given rise to dual-class stock structures, allowing some founders to retain control despite economic dilution. According to some, these structures insulate founders from short-termist pressures, presserving their unique vision and long-term orientation in firms whose value rests on sustained innovation rather than predictable cash flows.[[106]](#footnote-106) Moreover, dual-class structures enable firms that might otherwise remain private to access public capital markets without sacrificing founder control.[[107]](#footnote-107) Others, however, worry that these structures create agency costs by insulating founders from shareholder discipline.[[108]](#footnote-108) However, the debate over dual-class structures should not obscure the more fundamental sources of founder influence in intangible-heavy firms—their complementarity with the firm’s intellectual property and their leadership of technical teams.[[109]](#footnote-109)

The combination of IP consolidation, reverse vesting, transfer restrictions, and dual-class structures creates a sophisticated governance framework that transforms founder equity from simple ownership into a commitment mechanism that channels entrepreneurial energy toward value creation. Thus, the architecture of founder ownership reflects the functional logic of the optional firm. It enables founders to capture the upside of success while remaining aligned with capital and human capital providers. The following section examines how employee equity-based instruments contribute to this alignment.

### Employee Incentives and Retention Mechanisms

As venture-backed firms scale beyond their founding teams, the human capital hold-up and spillover dynamics discussed above create acute retention challenges.[[110]](#footnote-110) The equity-based instruments that have evolved to address these challenges represent a second layer of the optional firm’s governance architecture.

Stock options have emerged as the primary mechanism for aligning employee incentives with firm performance while addressing the mobility dilemma inherent in innovation-driven enterprises. Unlike traditional salary-based compensation, options create performance-contingent rewards that vary directly with firm success, providing powerful retention incentives for employees of growing companies through progressive vesting and tax benefits, while allowing natural attrition from underperforming ventures.[[111]](#footnote-111) This selective retention effect functions as an efficient alternative to traditional non-compete agreements, particularly valuable in jurisdictions like California, where such agreements are unenforceable.[[112]](#footnote-112)

The standard option structure grants employees the right to purchase company shares at a predetermined exercise price, typically set at fair market value on the grant date.[[113]](#footnote-113) The vesting schedule links ownership in the securities to the duration of the employee’s work for the company, with the industry standard being four years, with a quarter of the grant vesting after one year (the “cliff”), and proportionate monthly or quarterly vesting thereafter.[[114]](#footnote-114) This structure prevents departing employees from retaining significant equity stakes without contributing to firm development, addressing the “dead equity” problem that creates free-rider issues and reduces the equity available for future talent acquisition.[[115]](#footnote-115)

The expiration mechanism of incentive stock options provides additional retention pressure. While options typically have lengthy terms (seven to ten years), upon termination of employment, employees must decide within a short period (usually 90 days) whether to exercise their options or forfeit them.[[116]](#footnote-116) Since startup shares are illiquid, exercising options involves considerable financial risk and capital commitment, making continued employment often more attractive than departure.

Beyond initial stock option grants, companies systematically deploy “refresh grants” to maintain alignment as circumstances evolve.[[117]](#footnote-117) These subsequent grants refresh the incentive to remain after the original vesting schedule nears completion, following declines in stock value, or when employees’ market value increases.[[118]](#footnote-118) Refresh grants reflect marginal productivity and evolving firm needs rather than length of service alone, allowing companies to dynamically adjust retention incentives based on changing strategic priorities and individual contribution levels.[[119]](#footnote-119)

From the perspective of diversified investors, this approach proves superior to non-compete agreements. Options become valuable only when companies succeed and create intellectual property worth protecting, while non-compete agreements require premium payments even when R&D efforts fail to create significant value.[[120]](#footnote-120) Moreover, since venture capital funds are repeat investors, non-compete agreements harm them in the long term by reducing investment opportunities in new companies formed by alumni of their other portfolio firms.[[121]](#footnote-121)

As venture-backed companies mature and valuations increase substantially, however, many transition from stock options to RSUs for employee compensation.[[122]](#footnote-122) This shift reflects both regulatory constraints and strategic considerations. Under Section 409A of the U.S. Internal Revenue Code, stock options must be granted at fair market value to avoid adverse tax consequences, making them prohibitively expensive for employees at high-valuation companies.[[123]](#footnote-123) RSUs address this issue by granting company stock directly, subject to vesting conditions, eliminating the need for an exercise price or financial decision by the employee. For this reason, mature startups, known as unicorns, often adopt “double-trigger” RSUs.[[124]](#footnote-124) These RSUs vest only when both a service requirement (typically the four years vesting schedule) and a liquidity event requirement are met. Unlike stock options, which can become worthless if the company’s stock price falls below the exercise price, RSUs generally retain some value as long as the stock has any positive worth, , but they typically expire if the startup does not experience a liquidity event within seven years from the grant date.[[125]](#footnote-125)

As firms delay going public, creating an illiquidity challenge for employees, scholars debate whether these equity compensation arrangements systematically disadvantage workers.[[126]](#footnote-126) Yet even amid concerns over fairness and risk allocation, the underlying logic remains the same: venture-backed startups rely on equity instruments not merely as compensation but as a governance tool to bind human capital to the venture through conditional ownership, transforming employees into stakeholders whose fortunes rise and fall with the firm’s success.

## Strategic Partners, Suppliers, Lenders, and Customers

In addition to venture capital and human capital, venture-backed startups often rely on strategic partners and platform users for value creation, particularly in intangible-intensive firms where network effects and ecosystem interoperability drive competitive advantage.[[127]](#footnote-127) These external stakeholders provide complementary resources and capabilities that may be difficult to replicate internally. Their contributions often involve relationship-specific investments that create vulnerability to hold-up problems, as documented in transaction cost economics literature.[[128]](#footnote-128) Startups increasingly offer equity-based instruments to critical external stakeholders in an attempt to align these stakeholders’ incentives with the venture’s long-term success. This transforms conventional transactional relationships into partnerships with shared economic interest.

Platform companies in particular have pioneered innovative approaches to downstream stakeholder equity participation. Airbnb, facing the challenge of maintaining high-quality inventory in competitive markets, offered hosts the opportunity to purchase shares worth $238 million during its 2020 IPO through a directed share program, aligning the long-term interests of property owners with its own.[[129]](#footnote-129) Uber similarly reserved approximately 3% of its IPO shares (5.4 million shares) for qualifying drivers who had completed at least 2,500 trips, through a directed share program in 2019.[[130]](#footnote-130) Reddit has employed this strategy multiple times, first announcing plans to share 10% of its equity with its most active content creators and moderators in a 2014 funding round led by Sam Altman,[[131]](#footnote-131) and then in 2024 creating a directed share program for its IPO that reserved approximately 8% of shares (1.76 million out of 22 million total shares) for “eligible users and moderators” who had meaningfully contributed to Reddit community programs.[[132]](#footnote-132) Robinhood reserved 20% to 35% of its IPO shares for platform users in July 2021, recognizing their role as key contributors to the platform’s network effects and value creation and thereby integrating them into the firm’s contingent shared ownership structure.[[133]](#footnote-133) Looking ahead, blockchain-based tokenization presents an emerging mechanism for platforms to distribute fractional ownership stakes to stakeholders, potentially offering more granular approach to stakeholder equity participation than traditional directed share programs.[[134]](#footnote-134)

For some time, startups have also developed equity bonds with strategic partners (i.e., established corporations that provide specialized resources, market access, or technology) including through the corporate venture capital arms of these corporations.[[135]](#footnote-135) These arrangements enable startups to receive funding from entities with industry expertise while giving corporate partners a window into emerging technologies and business models. More recently, AI startups have established equity relationships with large technology firms that go beyond traditional corporate venture capital.[[136]](#footnote-136) While conventional corporate venture capital typically involves minority investments across diverse portfolios, contemporary AI-focused investment arrangements often feature deeper integration and more extensive resource commitments.[[137]](#footnote-137) These arrangements frequently include dedicated computing resource provision, specialized licensing terms, and milestone-linked financing structures.

Even more recent developments in 2024 and 2025 demonstrate the evolution of these arrangements into hybrid structures that combine talent acquisition and technology licensing.[[138]](#footnote-138) These developments have given rise to an increasing debate concerning selective *acqui-hires*,[[139]](#footnote-139) such as the July 2025 controversy involving Google’s $2.4 billion acquisition of AI startup Windsurf, where Google hired only the startup's founders and key executives while leaving 250 employees behind.[[140]](#footnote-140) Such arrangements raise concerns that breaking startups into their component parts may prove risky for lower-level employees. These employees traditionally benefit from alignment with founders and the complementarity between founders’ human capital and the firm’s intellectual property.[[141]](#footnote-141) However, this protection is severed when founders depart to major technology companies that also gain access to the intellectual property through licensing arrangements, leaving rank-and-file employees with diminished firm assets and no leadership.

Lastly, beyond direct equity participation, convertible debt instruments and warrant-backed lending offer strategic stakeholders alternative pathways to engage in contingent ownership arrangements. Suppliers, strategic partners, and lenders may opt for convertible notes, SAFEs, or traditional debt paired with warrants instead of immediate equity positions, because these instruments allow participation in potential upside while maintaining the flexibility of a debt or contractual relationship until conversion or exercise occurs.[[142]](#footnote-142) These hybrid instruments help mitigate information asymmetries and timing mismatches in valuation between stakeholders and startups, particularly in early-stage ventures. For instance, a critical supplier might extend favorable payment terms in exchange for a convertible note that converts to equity at a discount in the next funding round, or a bank might provide a loan alongside warrants representing, for example, 5-20% of the loan amount, aligning long-term interests with the startup’s success while retaining senior creditor status. These approaches are valuable for stakeholders seeking streamlined documentation, facing regulatory restrictions on direct equity ownership (e.g., banks in certain jurisdictions), or preferring to defer valuation negotiations until the company achieves clearer milestones.

In sum, the extension of equity participation to diverse stakeholders, including platform users, strategic partners, suppliers, and lenders, illustrates the evolution of contingent shared ownership beyond traditional venture boundaries. Yet the emergence of selective *acqui-hire* arrangements reveals the inherent fragility of the optional firm structure: when founders and key talent can be extracted individually, it severs the complementarity between human capital and intellectual property that sustains the broader stakeholder coalition.

# II. Contingent Shared Ownership and the Capital Structure of Startups

The capital structure of venture-backed startups plays a central role in their governance, serving as the glue that binds the firm’s key elements together. This Part describes the mechanics of contingent shared ownership in venture-backed startups, examining how liquidation waterfalls distribute proceeds among stakeholders and how these structures evolve through successive financing rounds.

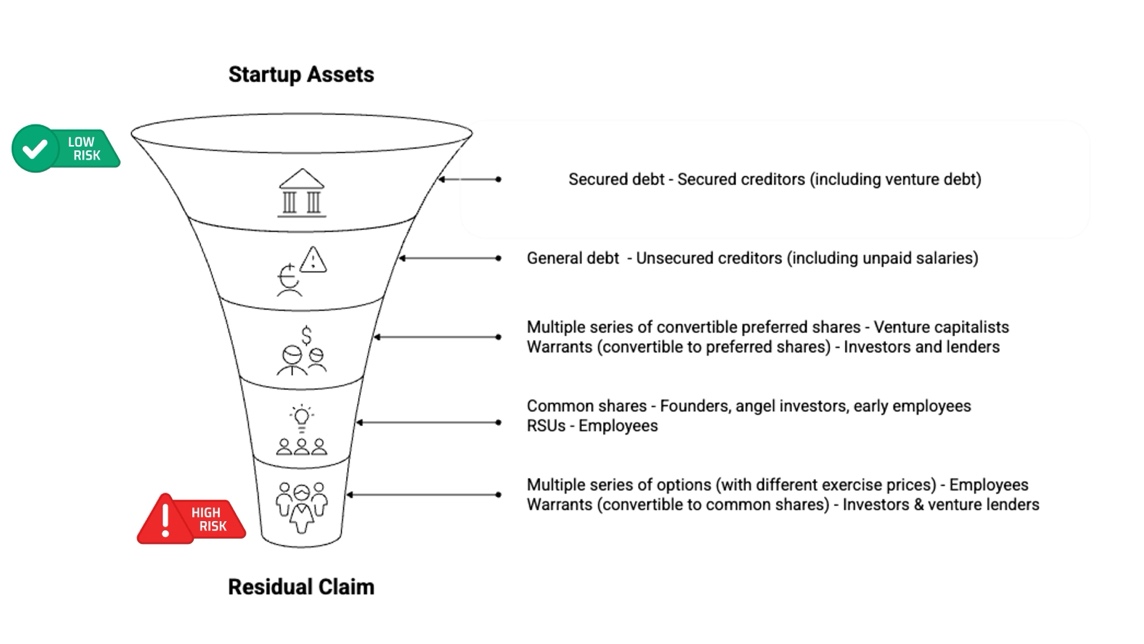
## Defining Contingent Shared Ownership

Contingent shared ownership refers to an ownership architecture in which the residual claim, the right to share in the firm’s economic upside after debt is paid in full, is distributed among diverse set of stakeholders. As described in detail in Part I, the capital structure of venture-backed startups consists of various securities that align the interests of investors, founders, employees, and others. Founders hold common stock, a residual claim typically subject to reverse vesting and transfer restrictions that reinforce long-term commitment.[[143]](#footnote-143) Investors receive convertible preferred stock, which combines downside protection through liquidation preferences with upside participation via conversion rights.[[144]](#footnote-144) Employees, in addition to receiving fixed salaries, are granted stock options or RSUs that vest over time and reward sustained employment, thereby transforming mobile human capital into long-term participants in the firm’s success. [[145]](#footnote-145) Some startups also extend equity to platform users, strategic partners, lenders, and other stakeholders, integrating them into the ownership structure to promote aligned incentives and sustained engagement.[[146]](#footnote-146)

Ownership is *shared* in that it departs from traditional corporate models, where the residual claim is held by a homogeneous group of investors alone, while others are compensated through fixed wages or fees.[[147]](#footnote-147) The model resonates with the concept of “shared capitalism,” which encompasses compensation practices that tie employees’ income to firm performance.[[148]](#footnote-148) However, contingent shared ownership is both broader and more restrictive: broader because the upside is shared with a range of stakeholders beyond employees; more restrictive because these rights are not guaranteed but contingent on the firm’s success.[[149]](#footnote-149)

The resulting priority of claims, illustrated in **Figure A**, is multi-tiered, granting fixed and residual rights to various providers of financial and human capital.

Figure A. Multi-Tiered Priority of Claims in Startup Capital Structure



This layered distribution framework sets the stage for the liquidation waterfall, the methodology that determines how and when each stakeholder is compensated during a liquidity event.

## Liquidation Waterfall and Exit Payouts

Contingent shared ownership is implemented through a liquidation waterfall that dictates the sequence of payouts during a liquidity event, such as an acquisition or IPO. Initially, proceeds are used to settle outstanding debts, prioritizing secured creditors (e.g., bank loans or bonds) followed by unsecured creditors (e.g., vendors or bondholders without collateral). However, due to their intangible-heavy nature, startups typically carry little debt, making this step less significant than in traditional businesses.[[150]](#footnote-150)

Next, preferred shareholders receive their liquidation preferences based on their seniority, as outlined in the company’s charter and shareholder agreements. Preferred shareholders hold the right to convert their shares into common stock, typically at a 1:1 ratio, subject to terms specified in the company’s charter. Conversion may occur automatically or at the shareholder’s discretion when it yields a higher payout than the liquidation preference, such as in a high-value IPO or acquisition.[[151]](#footnote-151) In companies with multiple financing rounds, different classes of preferred stock (e.g., Series A, B, C) exist, each with distinct rights and seniority that determine their position in the payout hierarchy. Later-stage investors often negotiate seniority provisions that place them ahead of earlier investors in the liquidation waterfall. Alternatively, some classes may be structured to share proceeds on a *pari passu* basis, meaning they are treated equally in the distribution of liquidation proceeds. The terms of each preferred stock class, including liquidation preference multiples (e.g., 1x, 2x), participation rights (e.g., participating or non-participating, sometimes with caps limiting total payouts), and cumulative dividends (which accrue annually and increase the liquidation preference), significantly influence the distribution of proceeds.[[152]](#footnote-152) In addition, some investors or lenders may hold warrants that are convertible into preferred shares, entitling them to the same senior rights and preferences upon conversion, which further affects the distribution landscape.

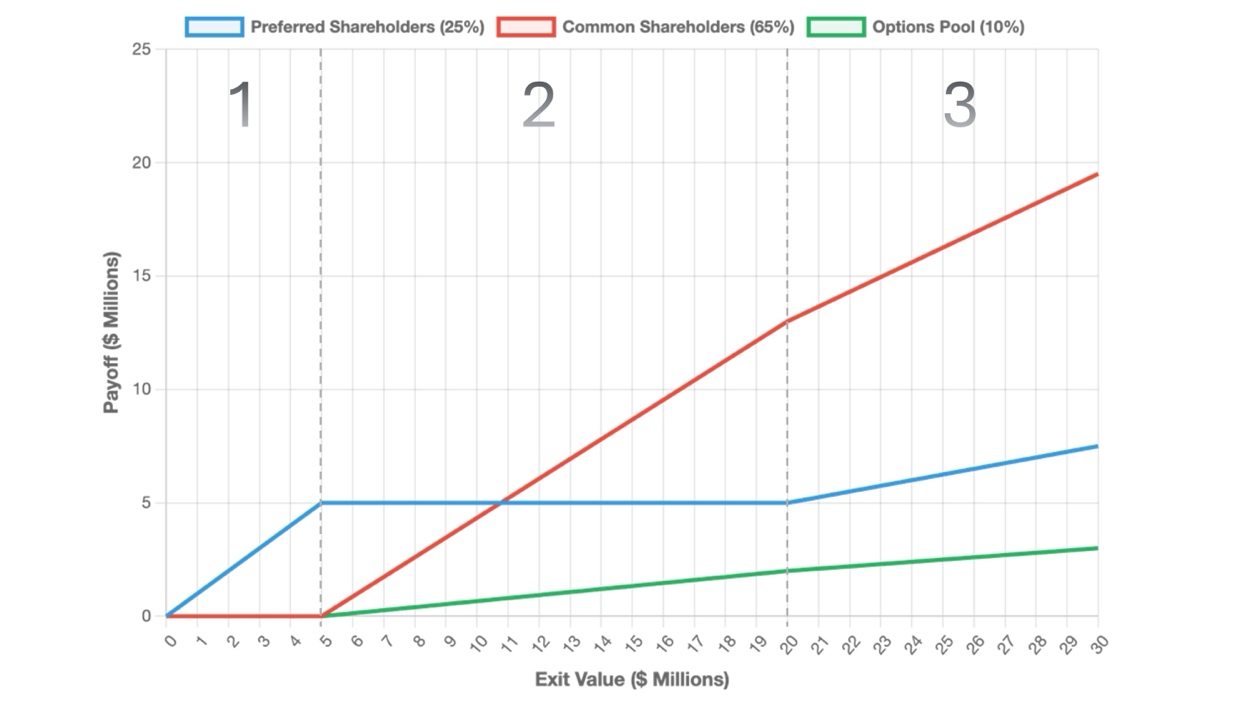
Common shareholders—typically founders, early employees, and early investors such as “friends, fools, and family”—receive proceeds only after all senior claims, including debt obligations, liquidation preferences, and accrued dividends, have been satisfied.

Employee stock options do not constitute a distinct tier in the liquidation waterfall because they are not equity claims until exercised. Instead, they confer the right to purchase common stock at a predetermined exercise price. Their value depends on whether the residual value of the company, after all senior claims such as debt and preferred equity have been satisfied, is sufficient to make the common stock valuable. If the residual value allocated to common shareholders implies a per-share price below the option’s exercise price, it may not be economically rational to exercise the option, and the option may expire worthless. Conversely, if the per-share value of common stock exceeds the exercise price, the option is likely to be exercised and converted into common stock, which ranks below all other claims in the distribution hierarchy. Because firms typically grant stock options with an exercise price equal to the fair market value of common stock on the grant date,[[153]](#footnote-153) employees who join the company at different times often hold options with different exercise prices and therefore face different thresholds for when it becomes economically rational to exercise them.

To make these dynamics more concrete, let us consider two simplified examples of how the liquidation waterfall operates under different exit scenarios, first in a seed-stage financing that creates Series S preferred stock, and then in a subsequent Series A financing that introduces a new class of preferred shares, Series A. These illustrations demonstrate how capital structure evolves over time as new investors are added and how payout outcomes depend on the total liquidation preferences and the residual value available to common stock.

Figure B illustrates a seed-stage capital structure with a typical 1x non-participating liquidation preference. Preferred shareholders are entitled to the first $5 million of exit proceeds and hold 25% of the company on an as-converted basis. Common shareholders hold 65%, and 10% is allocated to the employee option pool. The x-axis shows total exit value; the y-axis shows how proceeds are distributed among stakeholders. The slope of each line changes at key “breakpoints” where distribution rules shift—first when the $5 million liquidation preference is fully paid, and later when preferred shareholders convert to common stock to benefit from a higher pro rata share of the exit.

Figure B. Waterfall Scenarios – Seed Financing



**Scenario 1 (Exit ≤ $5M):** Preferred shareholders receive all proceeds up to their $5M liquidation preference. Common shareholders and options receive nothing.

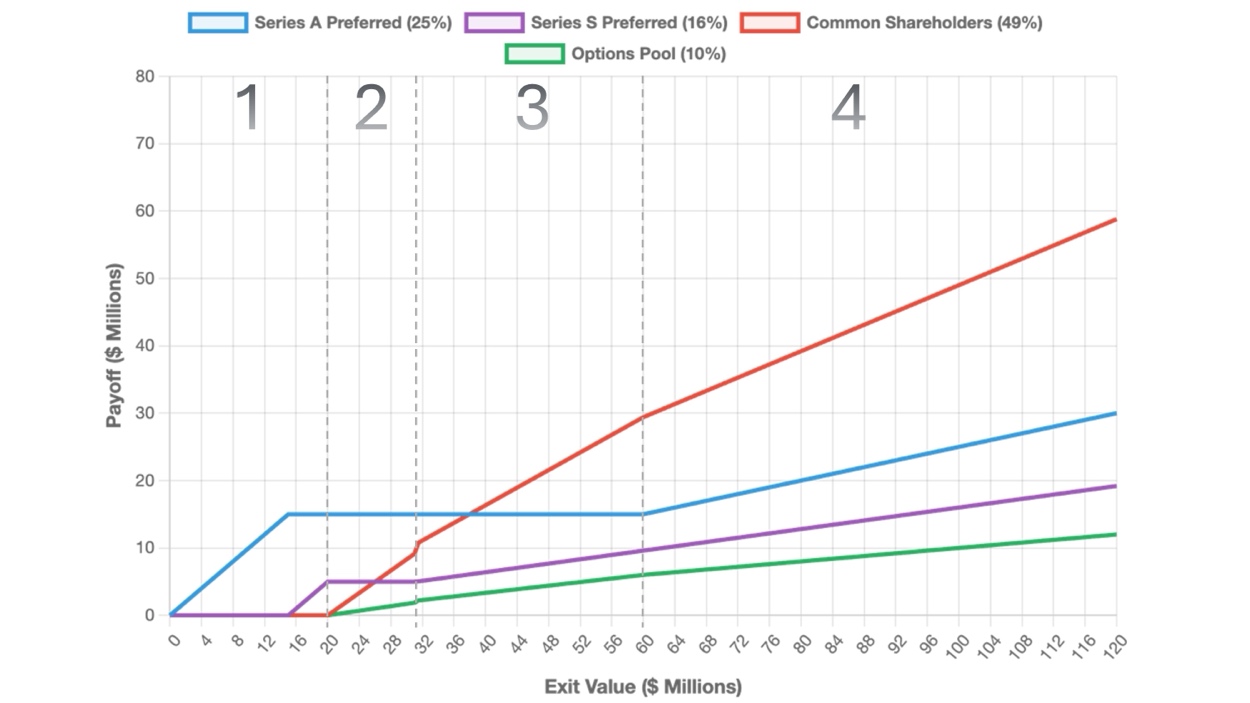
**Scenario 2 ($5M < Exit < $20M):** Preferred shareholders receive their full $5M preference. The remaining proceeds go to the common equity and are divided proportionally within it, meaning common shareholders receive 86.67% and option holders receive 13.33% of the residual, reflecting their respective ownership shares (65% versus 10%).

**Scenario 3 (Exit ≥ $20M):** Preferred shareholders convert to common stock. All shareholders participate proportionally (“*pro rata*”): 25% preferred, 65% common, 10% options.

**Figure C** illustrates the evolution of the company’s capital structure following an up-round—a Series A financing conducted at a higher valuation than the preceding seed round. The firm now has two classes of preferred stock: Series A, which holds a $15 million 1x non-participating liquidation preference and owns 25% of the company on an as-converted basis. Series S, created in the seed round, holds a $5 million preference and now owns 16% of the company. This reflects dilution from the Series A round, which introduced new investors holding 25% of the fully diluted capitalization, reducing the combined stake of earlier shareholders from 100% to 75%.

Notably, the employee option pool remains at 10%, undiluted by the Series A investment. This reflects a common market practice in which incoming investors require the company to expand the option pool before the financing, so that it is included in the pre-money capitalization. As a result, the dilution from creating or topping up the pool is borne entirely by existing shareholders**,** the common stockholders and earlier investors**,** rather than by the new investors.

Figure C. Liquidation Waterfall – A Round Financing



**Scenario 1 (Exit ≤ $20M):** Preferred shareholders receive proceeds in order of preference. Series A gets first $15M, Series S gets next $5M. Common shareholders receive nothing until preferences are satisfied.

**Scenario 2 ($20M < Exit < $31.25M):** After preferences are paid, remaining proceeds go to common shareholders. Both preferred series still take their liquidation preferences.

**Scenario 3 ($31.25M < Exit < $60M):** Series S converts to common (16% × Exit > $5M preference), but Series A still takes $15M preference. Remaining proceeds split among Series S, Common, and Options proportionally.

**Scenario 4 (Exit ≥ $60M):** Both preferred series convert to common stock. All shareholders participate proportionally: Series A (25%), Series S (16%), Common (49%), Options (10%).

Therefore, within the remaining 75%, Series S retains its relative ownership, resulting in a 16% post-Series A stake, while common shareholders hold 49%, and the employee option pool accounts for 10%. As exit value increases, the capital structure shifts from fixed preferences toward pro rata sharing, with conversion decisions dynamically reshaping payouts based on the relative value of fixed versus residual claims.

Of course, this is merely an illustrative example. In practice, financing terms are heavily influenced by prevailing conditions in private capital and talent markets. When capital is scarce, investors often negotiate stronger downside protections, such as higher liquidation preference multiples (e.g., 2x), cumulative dividends, or more aggressive anti-dilution provisions, to mitigate risk.[[154]](#footnote-154) Conversely, in environments where capital is plentiful or talent is scarce, companies may offer larger equity grants or more favorable option terms to attract and retain key personnel.[[155]](#footnote-155)

Each financing round requires a careful rebalancing of incentives to align the interests of founders, employees, and investors while limiting dilution for existing shareholders.[[156]](#footnote-156) This ongoing negotiation reflects the central challenge of contingent shared ownership: structuring deals so that contributors of labor and knowledge can maintain meaningful stakes even as new capital enters and reshapes the ownership structure. The liquidation waterfall framework reveals how these competing claims are reconciled through embedded optionality that adapts to the firm’s evolving valuation and risk profile.

The next Part shifts from these payout dynamics to questions of governance, exploring how the distinctive features of startup firms, particularly their reliance on intangible assets and layered ownership structures, generate governance dynamics that differ markedly from those in public companies and conventionally financed private firms.

# III. Toward a Unifying Theory of Startup Governance

Scholars have proposed various explanations for the financing structures and incentive mechanisms commonly used in venture-backed startups. These explanations fall into two broad categories: those grounded in the principal-agent problem and those based on the theory of team production. This section briefly outlines how each framework applies to startups and then proposes a synthesis that captures the distinctive governance logic of the venture-backed firm.

## The principal-agent problem

The principal-agent problem offers a foundational lens for understanding corporate governance, particularly the tension arising from the separation of ownership and control. In 1932, Adolf Berle and Gardiner Means highlighted the challenges in public corporations stemming from dispersed ownership, noting that managers may prioritize their own interests over those of shareholders, leading to agency costs.[[157]](#footnote-157) In their seminal 1976 article, Michael Jensen and William Meckling formalized this problem, modeling the firm as a nexus of contracts that balances the interests of various parties.[[158]](#footnote-158) Their framework describes a principal (the shareholder) delegating decision-making to an agent (the manager), whose interests may diverge due to information asymmetries and conflicting incentives.[[159]](#footnote-159) This misalignment generates three types of agency costs: monitoring and incentive costs borne by the principal, bonding costs incurred by the agent to gain the principal’s trust, and unavoidable residual losses.[[160]](#footnote-160) While Jensen and Meckling presented their model as descriptive analysis rather than prescriptive guidance, it nevertheless carried powerful normative implications that profoundly shaped corporate law, promoting the view that its primary goal is to minimize agency costs by aligning managerial and shareholder interests.[[161]](#footnote-161) This perspective underpins the prevailing doctrine that a corporation’s purpose is to maximize shareholder value.[[162]](#footnote-162)

Shareholders’ primacy in this framework stems from their unique position relative to other stakeholders. As holders of residual claims, shareholders bear the greatest risk in liquidation, incentivizing them to monitor management to maximize firm value.[[163]](#footnote-163) This oversight indirectly benefits fixed-claim stakeholders (e.g., creditors and employees), as residual claims are valuable only if the firm meets its obligations.[[164]](#footnote-164) Unlike fixed-claim holders, who can contractually mitigate risks, shareholders face greater uncertainty in defining actions to enhance residual value.[[165]](#footnote-165) Additionally, shareholders’ diversified portfolios make them less risk-averse than fixed-claim stakeholders, fostering risk-taking that drives economic growth.[[166]](#footnote-166) Furthermore, shareholder primacy does not diminish other stakeholders’ importance but reflects a division of labor in legal systems: labor law protects employees, tort law safeguards involuntary creditors, contract law governs voluntary creditors, and corporate law focuses on shareholders, who lack equivalent protections elsewhere.[[167]](#footnote-167)

In technology startups, the principal-agent problem is particularly pronounced due to the firms’ reliance on growth potential rather than tangible assets. This creates significant information asymmetries between entrepreneurs and investors, exacerbating agency costs and adverse selection, which complicates assessing investment quality and monitoring entrepreneurial actions. Venture capital scholars have applied the principal-agent framework to explain key features of startup governance, including staged financing, [[168]](#footnote-168) syndication,[[169]](#footnote-169) venture capital funds representation on boards,[[170]](#footnote-170) convertible preferred shares with liquidation preferences,[[171]](#footnote-171) intensive use of equity-based compensation,[[172]](#footnote-172) and conflicts over exit strategies.[[173]](#footnote-173)

However, the principal-agent model has limitations in capturing the dynamics of venture capital-backed startups. The traditional framework distinguishes between principals (capital providers, typically shareholders) and agents (human capital providers, such as managers).[[174]](#footnote-174) In startups, this dichotomy oversimplifies the complex, partnership-like relationships among stakeholders.[[175]](#footnote-175) Venture capital funds, for instance, are principals as shareholders but also act as agents through board representation, wielding superior information and decision-making power that can disadvantage entrepreneurs, employees, or angel investors holding common shares. Similarly, entrepreneurs and employees are both principals (as equity holders) and agents (as decision-makers managing daily operations). The literature often overlooks this duality, framing venture capitalists solely as principals and entrepreneurs as agents, while neglecting employees’ status as equity partners despite their significant ownership through stock-based compensation.[[176]](#footnote-176)

The principal-agent model also struggles to account for the multi-directional and simultaneous agency conflicts in startups, between investors and entrepreneurs, entrepreneurs and employees, and even among investors themselves. Robert P. Bartlett critiques the model for treating preferred shareholders as a monolithic group, ignoring the nuanced differences in rights across share classes and the complex negotiations surrounding them.[[177]](#footnote-177) For example, the model fails to explain “pay-to-play” provisions, which strip preferred shareholders of rights if they do not provide additional financing proportional to their stake. Such provisions highlight the cooperative and dynamic nature of startup governance, which the principal-agent framework’s hierarchical and static lens struggles to capture.

Moreover, the principal-agent model overemphasizes investor monitoring and control, which aligns poorly with venture capital’s focus on maximizing growth potential rather than minimizing losses. In startups, upside potential outweighs downside protection, and the collaborative relationship between entrepreneurs and investors often aligns their interests, except in extreme cases.[[178]](#footnote-178) The model’s static view of conflict also fails to reflect the evolving nature of agency issues throughout a startup’s lifecycle, where the relevance of agency conflicts shifts as the company matures.[[179]](#footnote-179) Recognizing these limitations, scholars have proposed that startup governance may be better understood through alternative frameworks, such as the team production model, which emphasizes the collective contributions of diverse stakeholders.[[180]](#footnote-180)

## The team production problem

The principal-agent framework has long served as a cornerstone of corporate law, but it is not without critique. A significant challenge to this paradigm comes from Lynn Stout and Margaret Blair, who argue that the modern public corporation is better understood as a solution to a team production problem than as a principal-agent relationship.[[181]](#footnote-181) Their work builds on economic theories of the firm, particularly those addressing the challenges of collaborative production efforts.

Armen Alchian and Harold Demsetz, pioneers of the team production approach, explain the corporation’s existence as a mechanism for coordinating collective production.[[182]](#footnote-182) Team production occurs when multiple team members combine their inputs, including labor and other resources, to create a valuable output that cannot be easily attributed to individual contributions. Alchian and Demsetz identify three conditions for team production: (1) the output requires diverse resources, (2) these resources are controlled by multiple parties, and (3) the final product is indivisible, making it impossible to attribute contributions precisely.[[183]](#footnote-183) Under these conditions, contractual agreements alone struggle to prevent inefficiencies. Pre-agreed profit-sharing arrangements incentivize shirking and free riding, as individual rewards are only partially tied to performance. Conversely, retrospective profit distribution encourages opportunism and hold-up, as parties may strategically renegotiate or withhold effort to increase their right share before completion.[[184]](#footnote-184)

To address these issues, Alchian and Demsetz propose an organizational hierarchy where one party acts as a monitor, holding the residual claim, while others receive fixed claims. This structure underpins the modern corporation’s separation of labor (fixed claims for employees) and ownership (residual claims for shareholders).[[185]](#footnote-185)

Bengt Holmstrom extends this framework by highlighting the high cost or impracticality of monitoring individual contributions in large teams.[[186]](#footnote-186) He observes that the most effective way to eliminate incentives for free riding is to ensure each team member directly bears the cost of shirking. However, because individually measuring outputs and linking rewards to personal performance is typically infeasible in large groups, Holmstrom proposes an alternative approach known as “group penalties.”[[187]](#footnote-187) Under this mechanism, team members receive shares of residual profits only if the team collectively meets a predetermined productivity threshold. If productivity falls below this threshold, residual profits remain with the principal, who effectively “breaks the budget” by withholding full distribution.[[188]](#footnote-188) In other words, not all production profits must necessarily be allocated to team members.[[189]](#footnote-189) This structure encourages team members to internalize the costs associated with shirking without the need for costly individual oversight.

Building on Gary Becker’s distinction between general investments, which are transferable without loss of value, and firm-specific investments, which are more valuable within the firm than elsewhere,[[190]](#footnote-190) Raghuram Rajan and Luigi Zingales develop another important advancement to team production theory by emphasizing the role of asset ownership in incentivizing firm-specific investments.[[191]](#footnote-191) They argue that team production success hinges on encouraging firm-specific investments, but such investments expose contributors to opportunism by those controlling complementary assets.[[192]](#footnote-192) To mitigate this, team members prefer a neutral third party (not a production partner) to own and allocate access to these assets, further justifying the separation of labor and ownership.[[193]](#footnote-193)

Blair and Stout synthesize these insights, positing that corporations address the team production problem by coordinating diverse inputs from investors, employees, managers, creditors, and suppliers.[[194]](#footnote-194) Their theory emphasizes the board of directors’ role in rewarding firm-specific investments to sustain trust and collaboration (acting as a “mediating hierarch”).[[195]](#footnote-195) This perspective challenges shareholder primacy, particularly in public companies with independent boards, by recognizing employees as equal contributors to the production team due to their firm-specific human capital.[[196]](#footnote-196)

Subsequently, Blair and Stout’s team production framework has been adapted to analyze startup governance. Gordon Smith argues that the relationship between venture capitalists and entrepreneurs blends hierarchy and collaboration, resembling a partnership where each party contributes distinct resources and shares the resulting economic value.[[197]](#footnote-197) Smith aligns venture capital contracts with three team production principles: (1) a lead investor is needed to deter shirking, (2) this lead investor must have authority to “break the budget,” and (3) decisions should reflect collective outputs rather than individual efforts.[[198]](#footnote-198) Venture capital contracts reflect these principles through staged financing, which ties continued funding to team milestones, adjusts dilution based on company valuation, and positions the lead investor in later rounds as the entity who sets valuations.[[199]](#footnote-199) Low valuations in subsequent rounds act as collective punishment, diluting entrepreneurs and early investors if productivity falters.

Elizabeth Pollman further applies Blair and Stout’s team production model to startup boards, arguing it is particularly relevant to their governance dynamics.[[200]](#footnote-200) She views startup boards, composed of entrepreneurs, venture capital representatives, and sometimes independent directors, as an intermediary layer fostering trust for firm-specific investments. As entrepreneurs make firm-specific investments but gradually lose control to VC representatives, the board facilitates cooperation among stakeholders.[[201]](#footnote-201) Unlike principal-agent models, where independent directors primarily monitor entrepreneurs, Pollman sees their role as balancing the interests of entrepreneurs and investors.[[202]](#footnote-202) She also notes that startups face less tension with shareholder primacy than public companies, as stakeholders like employees often hold equity, aligning their interests with shareholders.[[203]](#footnote-203)

Despite its insights, the team production model, as adapted by Smith and Pollman from Blair and Stout’s group production theory, falls short of fully explaining startup governance.[[204]](#footnote-204) Pollman acknowledges that the theory’s relevance to startup boards is limited, not universal.[[205]](#footnote-205) Smith and Pollman have adapted Blair and Stout’s framework to analyze venture capital contracts and startup boards, respectively, yet their applications reveal both limitations and inconsistencies. For instance, Smith’s emphasis on entrepreneurs and investors as the core production team excludes employees, despite their significant contributions to startups through firm-specific human capital. Moreover, a contradiction emerges in identifying the entity that “breaks the budget”: Smith assigns this role to the lead investor in later funding rounds, while Pollman points to the independent director as the mediating intermediary. Neither scholar fully explains why startups frequently share residual claims with employees through equity grants, a practice that diverges from traditional corporate reliance on fixed claims. These gaps underscore that, while the principal-agent and team production frameworks illuminate certain facets of startup governance, neither offers a comprehensive theoretical lens for the intricate contractual arrangements that define these entities.

The following Part will explore another limitation of these theories: their failure to fully explain the corporate law approach to startups developed in Delaware.

# IV. Contingent Shared Ownership and Delaware Startup Law

Having examined in Parts I-III above how existing corporate governance theories fail to adequately describe the capital structures that characterize venture-backed startups, we turn now to explore how these same theoretical frameworks also fail to capture the legal doctrines that govern such enterprises.

## The *Trados* Doctrine and the Limits of Existing Theory

Under Delaware corporate law, which governs most venture capital-backed startups in the United States,[[206]](#footnote-206) directors face a clear mandate in conflicts between shareholders: they must prioritize maximizing the value of common shares over preferred shares. This principle, established in the landmark 2013 case *In re Trados Inc. Shareholder Litigation*, has shaped the fiduciary duties of directors in startup governance, particularly in scenarios involving competing shareholder interests.[[207]](#footnote-207) The Trados case has now been cited in numerous judicial opinions and extensive law review literature, making it a watershed moment in defining the fiduciary duties of corporate directors affiliated with investment funds (“constituency directors”).[[208]](#footnote-208)

In *Trados*, a once-successful startup faced declining performance, prompting the board to replace the CEO and confront a strategic dilemma: raise additional capital to pivot the business or seek a buyer. Raising capital could restore solvency but offered limited returns for venture capitalists, who, lacking board representation, favored a sale and refused further investment. The company secured a loan to stabilize its finances and resumed merger negotiations, ultimately accepting a $60 million cash offer. The proceeds were distributed as follows: $7.8 million to management (under a compensation plan that was adopted post-CEO replacement) and $52.2 million to preferred shareholders, whose liquidation preferences totaled $57.9 million. Common shareholders received nothing.

The Delaware Chancery Court rejected a motion for summary judgment, finding the board’s process tainted by conflicts of interest.[[209]](#footnote-209) This triggered the application of the “entire fairness” standard, which evaluates both procedural fairness and the substantive fairness of the transaction, including the price. The court’s decision to scrutinize the conflict under entire fairness review was premised on its observation that “the VC business model reinforces the economic incentives that the preferred stock’s cash flow rights create,”[[210]](#footnote-210) identifying what can be understood as an “opportunity cost conflict” where venture capitalists are drawn to reallocate time and effort from struggling companies to more promising companies in their portfolios.[[211]](#footnote-211)

After extensive evidentiary proceedings, the court found that, despite the board’s failure to demonstrate a fair transaction approval process, the price was fair because the common shares were deemed worthless at the time of the sale.[[212]](#footnote-212) The *Trados* ruling established that, in conflicts between preferred and common shareholders, directors must prioritize the interests of common shareholders, who hold the residual claim on the company’s assets.[[213]](#footnote-213) Preferred shareholders' rights, by contrast, are contractual and do not alter directors' fiduciary duties under corporate law.[[214]](#footnote-214)

Subsequent Delaware cases have reinforced the *Trados* doctrine and expanded its application beyond the original context. In *In re Nine Systems Corporation Shareholders Litigation*,[[215]](#footnote-215) the court examined a capital raise from existing investors (an “insider round”) and a recapitalization that diluted common shareholders’ ownership from 26% to 2%. The company later sold for $175 million, a significant increase from its $4 million valuation during the raise. The court criticized the approval process and applied the entire fairness standard but ultimately found the price fair, dismissing the lawsuit after six years of litigation. However, due to procedural deficiencies, the plaintiffs were awarded $2 million in legal fees.[[216]](#footnote-216)

Similarly, in *Fredrick Hsu Living Trust v. ODN Holding Corp*., the court upheld a claim that directors, appointed by the private equity fund Oak Hill, breached their fiduciary duties by accumulating cash to facilitate preferred share redemptions rather than reinvesting profits for growth.[[217]](#footnote-217) However, following the evidentiary proceedings, the court found in favor of the defendants, concluding that their conduct was entirely fair. The court determined that ODN’s decline stemmed from market conditions, primarily competition from Google, rather than Oak Hill’s cash accumulation strategy, rendering the common shares worthless regardless of the board’s strategy.[[218]](#footnote-218) Importantly, the ODN case demonstrated that conflicts can arise even when funds hold both common and preferred stock, as the court found that Oak Hill’s substantial liquidation preference still created diverging incentives despite its common stock ownership.

From the foregoing review of case law, it is apparent that the *Trados* doctrine, which mandates prioritizing common shareholders in conflicts with preferred shareholders, conflicts with Blair and Stout’s theory of corporate governance, which posits that boards should have broad discretion to mediate among stakeholders without being bound to any single group.[[219]](#footnote-219) Delaware law’s clear preference for common shareholders diverges from Blair and Stout’s framework, which envisions directors as neutral intermediaries balancing diverse interests.[[220]](#footnote-220)

The principal-agent model also struggles to fully account for the *Trados* doctrine’s mandate to prioritize common shareholders. For example, William Bratton and Michael Wachter, argue that *Trados* creates perverse incentives by forcing preferred stockholders in control to maximize common stock value rather than enterprise value.[[221]](#footnote-221)They contend that the current approach discourages venture capital investment by creating “holdup value” for underwater common shareholders and making it harder for venture capitalists to realize on their investments, even when selling at enterprise-maximizing prices.[[222]](#footnote-222) Similarly, Robert Bartlett, argue that *Trados’* focus on common stockholders may produce inefficient outcomes by compelling directors to pursue unprofitable strategies to benefit common shareholders, potentially at the expense of aggregate shareholder value.[[223]](#footnote-223) Bartlett suggests that the Trados rule could discourage venture capital investment by prompting investors to rely on more restrictive contracts to safeguard their interests, as they can no longer depend on directors’ broad fiduciary duties.[[224]](#footnote-224)

Taking a quantitative approach, Sarath Sanga and Eric Talley develop a formal model using options pricing methods to evaluate whether prioritizing common shareholders maximizes a company’s overall value.[[225]](#footnote-225) Their model analyzes how capital structure (common versus preferred shares), board control (by entrepreneurs or investors), and fiduciary duties (the Trados rule versus prioritizing preferred shareholders) interact, considering both the company’s intrinsic value and its potential value in a sale. They find that Trados often produces inefficient outcomes and argue that boards should instead prioritize preferred shareholders’ interests, with common shareholders protected through contract damages.[[226]](#footnote-226) While they acknowledge that companies could theoretically contract around *Trados*, they note this appears “cumbersome and uncertain” under current law.[[227]](#footnote-227)

This scholarly consensus about Trados' pernicious effects, however, encounters an inconvenient truth: venture capitalists themselves appear far less concerned than their academic observers. As evidence of this disconnect, Abraham Cable’s study, based on interviews with 20 Silicon Valley attorneys, indicates that *Trados* has not materially altered venture capital contract design, suggesting that this doctrine is in alignment with the internal logic of startup financing.[[228]](#footnote-228) Cable’s research reveals that while Trados has had modest effects on board process, with lawyers now advising boards to more systematically consider continuation value and, in some cases, allocate special payments to common shareholders, the case has not produced the dramatic changes in venture capital financing terms that scholars applying principal-agent theory predicted.[[229]](#footnote-229)

In conclusion, existing theoretical frameworks, whether Blair and Stout’s production team model or the principal-agent model, do not fully explain Delaware's *Trados* doctrine. Normatively, critics predict that investors would seek to circumvent the rule, yet empirical evidence (though limited) suggests otherwise. The *Trados* rule appears to align with the practical realities of startup governance, reflecting an internal logic not yet captured by prevailing corporate governance theories.

The following Section explores a theoretical synthesis that combines elements of both the production team and principal-agent models to better explain the Trados doctrine's practical coherence.

## Contingent Shared Ownership as Governance Synthesis

This section presents a novel synthesis of the principal-agent problem and the group production problem, termed “contingent shared ownership.” This framework integrates complementary aspects of both theories to address governance challenges in start-up companies, conceptualizing venture-backed startups as “an optional firm”, a voluntary, dynamic coalition of input providers who freely join or exit based on alignment with their opportunity costs and market conditions.

As a side note, the team production and principal-agent models need not be seen as conflicting; rather, they function as complementary aspects of the theory of the firm.[[230]](#footnote-230) The principal-agent problem arises from the need for a hierarchical overseer to manage team efforts. The apparent tension between these frameworks stems from Blair and Stout’s interpretation of the team production model.[[231]](#footnote-231) The term “synthesis” is used here to reflect Blair and Stout’s portrayal of their work as a transformative shift in corporate governance thinking,[[232]](#footnote-232) though some critics remain skeptical of its justification.[[233]](#footnote-233) Here, the proposed theory critiques certain elements of Blair and Stout’s interpretation of the group production model, adopts others, and demonstrates why contingent shared ownership, which is underlying the optional firm, offers a superior approach to existing frameworks.

The proposed theory begins with the recognition that investments in R&D and general human capital generate positive externalities,[[234]](#footnote-234) and that providers of human capital retain an inalienable right to exit, as courts do not enforce specific performance of labor contracts and employees cannot credibly commit to permanent employment.[[235]](#footnote-235) Unlike the prevailing theories that portray individuals as free riders seeking to shirk responsibility,[[236]](#footnote-236) the contingent shared ownership model views them as proactive contributors, eager to deploy their resources and skills within an organizational structure that aligns with their aspirations and maximizes the returns on their human capital.

Accordingly, at its core, the optional firm is characterized by structural flexibility and voluntary participation. It operates as a voluntary alliance among input providers—entrepreneurs, employees, investors, and others—each of whom retains the autonomy to exit at will.[[237]](#footnote-237) Loyalty is not presumed but must be continuously earned through renegotiation, with terms regularly adjusted to reflect evolving market conditions.[[238]](#footnote-238) In this framework, exit is not viewed as betrayal but as a natural consequence of the firm’s failure to deliver mutual benefit.[[239]](#footnote-239) The ability to depart underscores the optional firm’s central principle: participation is contingent on the firm’s capacity to deliver value that exceeds each party’s opportunity costs.[[240]](#footnote-240)

Venture-backed startups operate as experimental laboratories designed to test the viability of innovative ideas and their adaptation to market conditions, under resource-constrained and accelerated timelines.[[241]](#footnote-241) As is typical of experimentation, most outcomes will be disappointing—but the knowledge produced does not vanish; it flows forward, informing and enabling the success of future ventures.[[242]](#footnote-242) This experimental structure grounds the optional firm’s approach to firm failure and resource reallocation as necessary features of market adaptation rather than anomalies to be avoided.[[243]](#footnote-243)

As detailed in Part I.2.a., investments in R&D and general human capital increase the outside options available to entrepreneurs and employees, thereby raising their opportunity costs and heightening the risk that they will leave to join competitors or launch competing ventures. The optional firm mitigates these risks through a capital structure that aligns incentives and preserves cooperation among input providers:

First, venture capitalists hold preferred shares with liquidation preferences that implement a sophisticated asset control mechanism addressing the core challenge of human capital-intensive firms: how to encourage firm-specific investments when value creation depends on synergy between human capital and complementary assets.[[244]](#footnote-244) Following Rajan and Zingales' framework, founders assign all intellectual property to the corporate entity at incorporation, separating asset ownership from individual contributors and preventing hold-up risks.[[245]](#footnote-245) This structure creates contingent control over complementary assets: when firm value falls below the aggregate liquidation preference threshold, venture capitalists occupy a quasi-creditor position with priority claims over the firm's asset base; when the firm succeeds, preferred shares convert to common stock, aligning investors with founders and employees as equal residual claimants. This mechanism also operationalizes Holmstrom’s “group penalty” concept, where productivity thresholds determine residual value allocation.[[246]](#footnote-246) In underperforming startups, exit value below the preference stack renders common shares worthless, effectively transferring all residual value to preferred shareholders—functioning as collective punishment for insufficient team output (*see* Scenario 1 in Figures B and C, Part II.2.). Conversely, successful ventures trigger conversion, enabling pro rata distribution among all equity holders and preserving incentives for continued collaboration. The priority rights thus maintain separation between human capital providers and complementary assets while encouraging firm-specific investments. This mechanism also addresses an unresolved question in Blair and Stout's model: how to distribute residual surplus after covering opportunity costs.[[247]](#footnote-247) While Blair and Stout suggest that surplus allocation depends on the political power of parties, the optional firm resolves this through *pari passu* distribution upon conversion.[[248]](#footnote-248)

Second, founders and employees are rewarded through common shares and options, subject to reverse vesting or vesting schedules, respectively.[[249]](#footnote-249) The theory of contingent shared ownership helps explain why startup personnel receive equity stakes rather than fixed salaries alone. As discussed in Part I.2.a., equity participation helps offset the opportunity costs faced by human capital providers, reinforces their incentives to stay with the firm, and sustains the cohesion of the production team. While firm-specific investments can, in principle, be encouraged through wages and safeguarded by labor law,[[250]](#footnote-250) contingent shared ownership plays a distinct role: it is not primarily designed to induce such investments, but rather to mitigate the risk of losing general human capital and to preserve competitiveness in fluid and fast-moving talent markets. Corporate law supports this model by protecting residual claims, thereby enabling the optional firm to attract both financial and human capital through its flexible, incentive-aligned structure.

Third, the optional firm’s adaptability is exemplified by its use of staged financing, which adjust capital costs to reflect changing market conditions and firm-specific risk,[[251]](#footnote-251) and by mechanisms such as refreshment grants and option repricing, which realign equity incentives with the evolving opportunity costs of founders and employees.[[252]](#footnote-252) These mechanisms support a dynamic recalibration of the capital structure, maintaining alignment among venture capitalists, founders, employees, and others. The board of directors, acting as a mediating authority akin to Blair and Stout’s “mediating hierarchy,” oversees this process by approving the terms under which the firm raises both financial and human capital (i.e., equity compensation plans). Crucially, however, unlike Blair and Stout’s account, the board here responds not to internal consensus-building, but to external market pressures. Its function is to keep participation attractive relative to outside opportunities. Selection operates on both sides: investors choose which firms to fund, while human capital providers choose whether to remain or exit. This two-sided selection process produces a market-driven equilibrium in which the firm must constantly demonstrate value. When the capital table can no longer reconcile the opportunity costs of its key contributors, dissolution is not a failure but a rational redeployment of resources—an outcome that captures the core logic of the optional firm.

Critically, unlike Blair and Stout’s broader conception of the production team, which extends fiduciary protections to external stakeholders such as employees, creditors, suppliers, and even communities, the optional firm confines the reach of corporate law to equity holders listed on the firm’s capital table. Non-equity participants retain statutory and contractual protections, but their fixed claims do not rise to the level of residual interests warranting fiduciary oversight. This narrower allocation of fiduciary duty preserves the conventional boundary between contract and corporate law.

Moreover, Blair and Stout’s inclusive conception of the production team blurs the boundary between residual and contractual claims by extending fiduciary protections to stakeholders who do not bear residual risk, investor-centered critiques point in the opposite direction. Scholars such as William Bratton, Michael Wachter, and Sanga and Talley express concern that Delaware’s focus on common shareholders in *Trados* may produce inefficient outcomes by may compel directors to pursue strategies that benefit residual claimants at the expense of preferred investors, potentially undermining aggregate enterprise value.[[253]](#footnote-253) Yet such critiques overlook the distinctive logic of startup firms, where value depends less on static assets and more on the synergy between intellectual property and the active participation of founders and employees. A sale of the firm without their cooperation would likely capture only the limited value of standalone assets, severing the dynamic that makes the enterprise worth more than the sum of its parts. The *Trados* framework reflects the distinctive realities of startups by anchoring fiduciary duties in the residual claim which is most closely tied to ongoing human capital participation, thus reinforcing the incentive structure necessary to preserve enterprise value.

**Table A** summarizes the key differences between the principal-agent model, the team production theory, and the contingent shared ownership framework, focusing on their respective views of ownership, corporate purpose, board function, and underlying legal principles.

Table A: Contrasting Governance Models

|  |  |  |  |
| --- | --- | --- | --- |
|  | **Principal-Agent Problem** | **Team Production Problem** | **Contingent Shared Ownership** |
| **Who owns the company?** | Shareholders | The company belongs to all production team participants including employees, investors, creditors, suppliers and communities. | **The company belongs to all equity holders, including convertible claims** |
| **Company purpose** | Maximize shareholder value | Maximizes the joint welfare of the production team as a whole. | **Maximize common stockholder value** |
| **Board's role** | Sets corporate strategy and monitors management | Settle competing claims of production team participants, incentivize firm-specific investments by providing credibility to company commitment (protection against opportunism) | **Supervise and incentivize production team, allocate cash flow rights through ongoing capital table management, approve terms for raising capital and human capital, serve as liquidator when sustainable equilibrium among stakeholders becomes unattainable** |
| **Legal framework** | Shareholder primacy; directors cannot adopt business policy that denies value to shareholders | Boards enjoy broad discretion under business judgment rule; some states adopt stakeholder constituency statutes | **Delaware law distinguishes share types: officers' duty is to maximize common share value; preferred stockholders’ rights are valid at contractual level; when no value beyond preference liquidation rights exists, assets can be liquidated with proceeds to preference shareholders by liquidation priority order, leaving common shareholders empty-handed** |

# Conclusion

The architecture of venture-backed startups reveals a profound shift in the theory of the firm. These companies are not merely financed differently; they are governed and owned through a fundamentally distinct logic, one that responds to the inescapable reality that the assets most critical to value creation in today’s economy cannot be owned, collateralized, or compelled. In this environment, equity becomes not just a financial instrument but a governance technology: a means of aligning incentives among voluntary, mobile contributors who retain the ever-present option to walk away.

This Article has developed the concept of contingent shared ownership to explain the unique capital and governance structures of startups. It shows how layered equity claims, common stock, preferred stock, options, RSUs, and other hybrid instruments, function not merely to raise capital but to bind a coalition of founders, employees, investors, and strategic partners in a joint venture that exists only so long as the promise of future upside outweighs present alternatives. By recasting the firm as an optional structure, an open-ended alliance among co-investors in a risky but potentially transformative experiment, this framework unifies insights from principal-agent and team production theories, while transcending their respective limitations.

Moreover, this account sheds new light on a puzzle that has long confounded corporate law scholars: the *Trados* doctrine’s formal prioritization of common shareholders. Seen through the lens of contingent shared ownership, Delaware law does not undermine stakeholder interests; it upholds the sole claim that sustains their continued participation. The fiduciary duty to maximize common stock value thus functions as a legal anchor for a governance model defined by at-will participation, high opportunity costs, and firm-specific investment under radical uncertainty.

As startup structures spread beyond Silicon Valley, into other jurisdictions, asset classes, and sectors, the insights of contingent shared ownership may offer a general framework for corporate governance in the age of intangible capital. By grounding ownership not in hierarchy but in ongoing alignment, and by treating equity not as a fixed entitlement but as a conditional reward, the optional firm points toward a corporate form that is more adaptive, more dynamic, and more faithful to the realities of modern value creation.

1. Jean-Baptiste Rudelle, Co-Founder & CEO, Criteo, *Rewarding Talent: The Founder’s Guide to Stock Options*, Index Ventures, https://www.indexventures.com/rewarding-talent/insights-from-criteo (last visited July 17, 2025). [↑](#footnote-ref-1)
2. *Infra* Part I.1.c. [↑](#footnote-ref-2)
3. *Infra* Part I.2.a. [↑](#footnote-ref-3)
4. *Infra* Part I.2.b. [↑](#footnote-ref-4)
5. Success here means that the company’s selling price or market value upon an exit exceeds the liquidation preference stack, allowing residual value to flow to common shareholders and other equity-linked claimants. *See* Elizabeth Pollman, *Startup Failure*, 73 Duke L.J. 287, 330 (2022) (“In general, a startup can be said to fail when it ultimately fails to attract an acquirer willing to buy the company at a valuation that would provide a return to all equity holders and it falls short of reaching product maturity and business metrics suitable for going to public markets.”). [↑](#footnote-ref-5)
6. *Infra* Part I.1.b. [↑](#footnote-ref-6)
7. *Infra* Part I.3. [↑](#footnote-ref-7)
8. Foundational works demonstrate how debt contracts optimally allocate control rights contingent on performance, establishing the theoretical template that venture capital contracts later adapted for equity financing. *See e.g.,* Oliver Hart & John Moore, *Default and Renegotiation: A Dynamic Model of Debt*, 113 Q.J. Econ. 1 (1998); Oliver Hart & John Moore, *A Theory of Debt Based on the Inalienability of Human Capital*, 109 Q.J. Econ. 841 (1994). Classical works in venture capital contracting built on this insight and documented the use of preferred stock to shift control from entrepreneurs to investors in cases of poor business performance. *See* Philippe Aghion & Patrick Bolton, *An Incomplete Contracts Approach to Financial Contracting*, 59 Rev. Econ. Stud. 473, 491–49 (1992) (“it is always best to start first with entrepreneur control if that is feasible. If, however, entrepreneur control does not sufficiently protect the investor’s claims, one should go for contingent control. Finally, if that is still not enough to protect the investor’s interests, one wants to give full control to the investor.”); Steven N. Kaplan & Per Strömberg, *Venture Capitalists as Principals: Contracting, Screening, and Monitoring*, 91 Am. Econ. Rev. 426, 427 (2001) (“rights are allocated such that, if the company performs poorly, the VC’s obtain full control.”); Erik Berglof, *A Control Theory of Venture Capital Finance*, 10 J. L. Econ. & Org. 247 (1994); William W. Bratton, *Venture Capital on the Downside: Preferred Stock and Corporate Control*, 100 Mich. L. Rev. 891 (2002); *See* also Alvaro Pereira, *The Law of Contingent Control in Venture Capital*, 2023 Colum. Bus. L. Rev. 676, 679 (2023) (recent comparative analysis of the feasibly of contingent control in venture contracting in different jurisdictions). [↑](#footnote-ref-8)
9. *Infra* Part I.3. [↑](#footnote-ref-9)
10. *See* Peter Theil & Blake Masters, Zero to One: Notes on Startups, or How to Build the Future 86–87 (2014) (discussing the power law of venture capital returns and stating that “the best investment in a successful fund equals or outperforms the entire rest of the fund combined”); Hervé Lebret, *Venture Capital Is Not Even a Home Run Business. It’s a Grand Slam Business*, Start-Up (Oct. 3, 2016), https://www.startup-book.com/2016/10/03/venture-capital-is-not-even-a-home-run-business-its-a-grand-slam-business/. [↑](#footnote-ref-10)
11. *In re Trados Inc. S’holder Litig.,* 73 A.3d 17, 41 (Del. Ch. 2013) (“[G]enerally it will be the duty of the board, where discretionary judgment is to be exercised, to prefer the interests of the common stock . . . to the interests . . . of preferred stock”). [↑](#footnote-ref-11)
12. *See e.g.,* *The State of ESOPs in Asia*, Saison Capital, XA Network & Carta 30 (Nov. 2024), https://hkifoa.com/wp-content/uploads/2024/11/state-of-esops-in-asia-saison-capital.pdf. (reporting that by 2024, 78% of startups in Asia had implemented ESOPs, up from 62% in 2021, with many extending participation beyond senior management); Tech.eu, *5 Years of Not Optional Campaign Sees European Startups Catch Up on Employee Stock Options* (Oct. 28, 2024), https://tech.eu/2024/10/28/5-years-of-not-optional-campaign-sees-european-startups-catch-up-on-employee-ownership/; Hamza Shad et al., *Ownership Trends in Private Equity: 2024*, Carta (2024), https://carta.com/data/ownership-trends-private-equity-2024/ (documenting a 172% increase in employee stakeholders at PE‑backed companies since 2019 and noting most PE‑backed firms on Carta have issued equity to non‑executive employees). [↑](#footnote-ref-12)
13. *See e.g.,* Jonathon Haskel & Stian Westlake, Capitalism Without Capital: The Rise of the Intangible Economy 13–15 (2018) (describing the global shift toward intangible economy); Raghuram Rajan & Luigi Zingales, *The Governance of the New Enterprise* 33–34 (Nat’l Bureau of Econ. Research, Working Paper No. 7958, 2000), http://www.nber.org/papers/w7958 (arguing that corporate governance should shift focus from protecting shareholders to mechanisms for controlling and retaining human capital, as modern enterprises have transformed from vertically integrated firms relying on physical assets to organizations where human capital is the primary source of value). [↑](#footnote-ref-13)
14. *See* Rajan & Zingales, *supra* note 13 at 34 (highlighting that while stock options for executives are well-studied, the widespread use of employee stock options represents an important but understudied trend in this evolving corporate landscape). [↑](#footnote-ref-14)
15. *See e.g*., Robert P. Bartlett III, *Venture Capital, Agency Costs, and the False Dichotomy of the Corporation*, 54 UCLA L. Rev. 37, 42 (2006) (“to truly understand VC investment, it is essential to move beyond the traditional analytical frameworks used in corporate scholarship.”); Elizabeth Pollman, *Startup Governance*, 168 U. Pa. L. Rev. 155, 159–60 (2019) (describing the disconnect between prevailing theories and the unique structure of startups). [↑](#footnote-ref-15)
16. For the seminal work on the principal-agent problem in corporate law, see Michael C. Jensen & William H. Meckling, *Theory of the Firm: Managerial Behavior,* *Agency Costs and Ownership Structure*, 3 J. Fin. Econ. 305, 308 (1976). [↑](#footnote-ref-16)
17. *See* Pollman, *supra* note 15 at 159 (“Participants in startups often occupy overlapping and shifting roles”). [↑](#footnote-ref-17)
18. For the seminal work on team production application to corporate law, *see* Margaret M. Blair & Lynn A. Stout, *A Team Production Theory of Corporate Law*, 85 Va. L. Rev. 247, 253 (1999). [↑](#footnote-ref-18)
19. *See* Bartlett, *supra* note 15 at 43 (asserting that Blair and Stout’s team production model broadens corporate governance analysis to include various stakeholder conflicts but is limited to public firms and doesn’t address the intra-stakeholder conflicts or dynamic agency problems found in venture capital investment). [↑](#footnote-ref-19)
20. *See* Bartlett, *supra* note 15. [↑](#footnote-ref-20)
21. *See* Pollman, *supra* note 15. [↑](#footnote-ref-21)
22. *Cf.* Margaret M. Blair & Lynn A. Stout, *Team Production in Business Organizations: An Introduction*, 24 J. Corp. L. 743, 747 (1999) (arguing that stakeholder-specific investments create vulnerabilities requiring governance mechanisms such as independent boards to protect against opportunism). [↑](#footnote-ref-22)
23. *See* Yifat Aran, *Note, Beyond Covenants Not to Compete: Equilibrium in High-Tech Startup Labor Markets*, 70 Stan. L. Rev. 1235, 1273 (2018) (“Stock options, like noncompetes, mitigate the fear of expropriation and provide startups the incentive they need to invest in innovation and human capital. If the startup is successful, the employee’s incentive to appropriate the employer’s investments is offset against her anticipated payout when the company reaches liquidity”). [↑](#footnote-ref-23)
24. *Cf*. Blair & Stout, *supra* note 18 at 253 (rejecting the view that directors must serve shareholders exclusively, instead presenting the board as a mediating hierarch charged with protecting the firm-specific investments of all participants). [↑](#footnote-ref-24)
25. *See In re Trados Inc. Shareholder Litig*., *supra* note 11, at 40–41. [↑](#footnote-ref-25)
26. *Id.* [↑](#footnote-ref-26)
27. *See* Leo E. Strine Jr., *Poor Pitiful or Potently Powerful Preferred*, 161 U. Pa. L. Rev. 2025, 2028 (2013) (“[T]he law suggests that when push comes to shove, the board has a duty to prefer the common’s interests, as pure equity holders, over any desire of the preferred for better treatment based on some generalized expectancy that they will receive special treatment beyond their contractual rights”). [↑](#footnote-ref-27)
28. *See* Robert P. Bartlett III, *Shareholder Wealth Maximization as Means to an End*, 38 Seattle U. L. Rev. 255, 256 (2015) (Trados erroneously treats shareholder wealth maximization as an absolute end rather than as a means to maximize firm value.); William W. Bratton & Michael L. Wachter, *A Theory of Preferred Stock*, 161 U. Pa. L. Rev. 1815, 1886 (2013) (arguing Trados’ mandate to maximize common stock value can actually destroy overall enterprise value); Shachar Nir, *One Duty to All: The Fiduciary Duty of Impartiality and Stockholders’ Conflict of Interest,* 16 Hastings Bus. L.J. 1 (2020) (arguing for a fiduciary duty of impartiality among stock classes); Sarath Sanga & Eric Talley, *Don’t Go Chasing Waterfalls: Fiduciary Duties in Venture-Capital-Backed Start-Ups*, 53 J. Legal Stud. 21 (2024) (demonstrating, using a formal model, that the requirement to prioritize common shareholders is economically inefficient compared to a preferred-choose rule that would prioritize preferred shareholders’ interests with expectation damages to common shareholders). [↑](#footnote-ref-28)
29. *See* Blair & Stout, *supra* note 18, at 252 (“directors of public firms enjoy an extraordinary degree of discretion to pursue other agendas and to favor other constituencies, especially management, at shareholders’ expense”). [↑](#footnote-ref-29)
30. *See* Steve Blank, *A Startup Is Not a Smaller Version of a Large Company*, Steve Blank (Jan. 14, 2010), https://steveblank.com/2010/01/14/a-startup-is-not-a-smaller-version-of-a-large-company/. [↑](#footnote-ref-30)
31. *Cf.* *id.* (“A scalable startup is designed by intent from day one to become a large company… by either disrupting an existing market and taking customers from existing companies or creating a new market”). [↑](#footnote-ref-31)
32. Nicolas Crouzet, Janice C. Eberly, Andrea L. Eisfeldt & Dimitris Papanikolaou, *The Economics of Intangible Capital*, 36 J. Econ. Persp. 29, 29 (2022) (“Intangible capital is generally defined by what it lacks—that is, as productive capital that lacks a physical presence. Familiar and important examples include patents, software and databases, trademarks, customer lists, franchise agreements, and organization capital and firm-specific human capital”). [↑](#footnote-ref-32)
33. *See* Haskel & Westlake, *supra* note 13 at 158–70 (examine how the distinctive features of intangible assets, such as their lack of collateral value, uncertain returns, and high spillover potential, complicate traditional debt financing, and argue that supporting an economy centered on intangibles will require rethinking the roles of equity investment, financial institutions, and tax policy). [↑](#footnote-ref-33)
34. *Id* at 67–69, 162. [↑](#footnote-ref-34)
35. *Id* at 71–79. [↑](#footnote-ref-35)
36. *Id* at 64–67. [↑](#footnote-ref-36)
37. *Id* at 79–86. [↑](#footnote-ref-37)
38. *See* Scott Kupor, Secrets of Sand Hill Road: Venture Capital and How to Get It 42–53 (2019). [↑](#footnote-ref-38)
39. *Id.* [↑](#footnote-ref-39)
40. This dynamic reflects not only the inherent variability of building intangible asset-based businesses, but also the winner-takes-all tendency common in digital and networked markets. Once a firm achieves critical mass, whether through users, data, or influence, it can rapidly consolidate dominance, raise entry barriers, and capture a disproportionate share of industry value. *See* Theil & Masters, *supra* note 10 at 18. It also exemplifies Schumpeterian disruption, whereby innovative startups introduce transformative products or business models that displace incumbents and reconfigure entire sectors, amplifying the returns for successful ventures while rendering legacy businesses obsolete. *See* Joseph Schumpeter, The Theory of Economic Development (1934) (Redvers Opie trans., Transaction Publishers, 2012) (explaining “creative destruction,” where emerging technologies, production methods, and distribution channels compel established firms to rapidly evolve or become obsolete). [↑](#footnote-ref-40)
41. *See* Haskel & Westlake, *supra* note 13 at 87 (“All other things being equal, then, we would expect firms in an intangible-rich economy to exhibit more uncertainty”); *see* also Bronwyn H. Hall & Josh Lerner, *The Financing of R&D and Innovation*, in 1 Handbook of the Economics of Innovation 609, 610 (Bronwyn H. Hall & Nathan Rosenberg eds., 2010) (documenting the “funding gap” for investment in innovation). [↑](#footnote-ref-41)
42. *See* Haskel & Westlake, *supra* note 13 at 161–62; Marco Da Rin & Thomas Hellmann, Fundamentals of Entrepreneurial Finance 1–10 (2020); Allen N. Berger & Gregory F. Udell, *The Economics of Small Business Finance: The Roles of Private Equity and Debt Markets* *in the Financial Growth Cycle*, 22 J. Banking & Fin. 613 (1998). [↑](#footnote-ref-42)
43. *Id* at 166–67; *see* also Sebastian Mallaby, The Power Law: Venture Capital and the Art of Disruption 42–45 (2022) (describing how Georges Doriot’s American Research and Development Corporation, a publicly traded venture fund, faced pressure to demonstrate short-term earnings despite investing in speculative, long-horizon technologies). [↑](#footnote-ref-43)
44. *See* Hall and Lerner, *supra* note 41. [↑](#footnote-ref-44)
45. *See* Paul A. Gompers & Josh Lerner, The Venture Capital Cycle 3 (1999) (“Venture investors typically concentrate in industries with great deal of uncertainty… These firms typically have substantial intangible assets…”). [↑](#footnote-ref-45)
46. *See, e.g*., Kupor, *supra* note 38 at 69–71. [↑](#footnote-ref-46)
47. *Id*. [↑](#footnote-ref-47)
48. *Id*. [↑](#footnote-ref-48)
49. *See, e.g.*, David Rosenberg, *The Two “Cycles” of Venture Capital*, 28 J. Corp. L. 419, 432 (2003) (Delaware cases on general partner fiduciary duties focus on interpreting partnership agreements rather than default legal duties.); *see also* William W. Clayton, *High-End Securities Regulation: Reflections On the SEC’s 2022–23 Private Funds Rulemaking*, 13 Harv. Bus. L. Rev. 71, 107 (2023) (describing that, as demand for PE and VC investments increased, fund managers negotiated for more flexible non-price covenant terms in limited partnership agreements); Deborah A. DeMott, *Corporate Officers as Agents*, 74 Wash. & Lee L. Rev. 847, 869 (2017) (“Agency law acknowledges the possibility of contractual solutions by embracing a role for agreements between principals and agents that define in advance the applicable standard of performance.”). [↑](#footnote-ref-49)
50. Recently, some venture capital funds have transitioned to an “evergreen” structure, which departs from the traditional fixed-term, closed-end model. Roelof Botha, *The Sequoia Capital Fund: Patient Capital for Building Enduring Companies*, Sequoia Capital (Oct. 26, 2021), https://www.sequoiacap.com/article/the-sequoia-fund-patient-capital-for-building-enduring-companies/; Juri Zanieri, *Evergreen Funds: A New Paradigm for Investment in Private Markets*, Aquila Cap. (June 2023), https://www.aquila-capital.de/fileadmin/user\_upload/PDF\_Files\_Whitepaper-Insights/Aquila\_Capital\_Opinion\_Article\_Evergreen\_Funds.pdf. *See* also Kobi Kastiel & Yaron Nili, *The Rise of Private Equity Continuation Funds*, 172(1) U. Pa. L. Rev. 1, 16 (2024). [↑](#footnote-ref-50)
51. *See, e.g*., Kupor, *supra* note 38 at 66 (discussing the fund’s life cycle). [↑](#footnote-ref-51)
52. *See, e.g*., Yifat Aran & Nizan Geslevich Packin, *Due Diligence Dilemma*, U. Ill. L. Rev. (forthcoming 2025), https://papers.ssrn.com/abstract=5273659. [↑](#footnote-ref-52)
53. *See, e.g*., Andrew A. Schwartz, *Finite Ventures* (forthcoming CBLR 2025) (on file with author) at p. 41; Jean-Noël Barrot, *Investor Horizon and the Life Cycle of Innovative Firms: Evidence from Venture Capital*, 63 Mgmt. Sci. 3021, 3021 (2017). [↑](#footnote-ref-53)
54. *See, e.g*., Kupor, *supra* note 38 at 72–75. [↑](#footnote-ref-54)
55. *Id*. [↑](#footnote-ref-55)
56. *See e.g.,* William A. Sahlman, *The Structure and Governance of Venture-Capital Organizations*, 27 J. Fin. Econ. 473, 507 (1990); Paul A. Gompers, *Optimal Investment, Monitoring, and the Staging of Venture Capital*, 50(5) J. Fin. 1461 (1995). [↑](#footnote-ref-56)
57. *Id.* *See also* Ilya Strebulaev & Alex Dang, The Venture Mindset: How to Make Smarter Bets and Achieve Extraordinary Growth 175–77 (2024). (observing that this setup allows investors to “double down or quit,” scaling capital only after early indicators of success emerge). This flexibility is implemented through *preemptive rights,* which grant existing investors the right to participate in future rounds on a pro rata basis, allowing them to maintain their ownership percentage by purchasing additional shares before new investors can participate. If a start-up gains traction, investors can exercise these rights to avoid dilution; if it stalls, they can decline to participate and let their stake be diluted. [↑](#footnote-ref-57)
58. *See e.g.,* George G. Triantis, *Financial Contract Design in The World of Venture Capital*, 68 U. Chi. L. Rev. 305, 311 (2001) (describing the benefits of staged financing). [↑](#footnote-ref-58)
59. *See. e.g*., Mallaby, *supra* note 43 at 60. [↑](#footnote-ref-59)
60. *See, e.g*., Will Gornall & Ilya A. Strebulaev, *Squaring Venture Capital Valuations with Reality*, 135(1) JFE 120, 121 (2020) (“investors in these companies are given convertible preferred shares that have both downside protection (via seniority) and upside potential (via an option to convert into common shares.”); In recent decades, SAFEs (Simple Agreements for Future Equity) have proliferated as lighter-weight alternatives, especially for pre-seed or bridge financing, to traditional convertible preferred stock and convertible note structures. SAFEs preserve the same core logic: downside protection through priority in the liquidation waterfall and upside participation via conversion rights. *See* John F. Coyle & Jordan M. Green, *The SAFE, the KISS, and the Note: A Survey of Startup Seed Financing Contracts*, 42 Minn. L. Rev. 101, 105(2018). [↑](#footnote-ref-60)
61. A liquidation preference specifies the order in which investors are paid in a liquidation event, such as a sale of the company. A “1x” liquidation preference, the most common baseline, entitles preferred shareholders to recover the full amount of their investment before any proceeds are distributed to common shareholders. Higher multiples (e.g., 2x) or cumulative dividends can further enhance investor recovery. This structure is essential for aligning incentives between founders and investors: without it, founders might be tempted to pursue early or low-value exits that offer modest returns to themselves but fail to deliver a return of capital, let alone a profit, to investors. By placing investors first in the payout waterfall, liquidation preferences ensure that founders benefit economically only when they grow the company’s value beyond the capital contributed by the investors. *See e.g.,* Matthew Wansley, *Beach Money Exits*., 45 J. Corp. L. 151, 153 (2019). [↑](#footnote-ref-61)
62. The conversion ratio defines how many common shares each preferred share converts into, typically on a 1:1 basis. However, this ratio can be adjusted over time through anti-dilution protections. *See infra* note 64. [↑](#footnote-ref-62)
63. Participation rights determine whether investors share in any remaining proceeds after receiving their liquidation preference. In a participating preferred structure, investors receive their preference amount and then participate pro rata, alongside common shareholders, in the residual distribution. This “double dip” increases investor upside and can significantly reduce what remains for founders and employees, especially in middling exit scenarios. By contrast, non-participating preferred investors must choose either the liquidation preference or conversion to common shares, but not both. *See, e.g., Understanding Liquidation Preference and Participation*, Alphabridge, https://alphabridge.co/featured/understanding-liquidation-preference-and-participation/ (last visited July 23, 2025). [↑](#footnote-ref-63)
64. Anti-dilution protections are triggered when the company issues new shares at a lower price per share than that paid by earlier investors, a so-called “down-round.” These provisions protect early preferred shareholders from economic dilution by adjusting the conversion price of their preferred stock, which in turn increases the number of common shares they receive upon conversion. The most common form is weighted average anti-dilution, which modifies the conversion price based on both the price and volume of the new issuance. This results in a blended price that partially offsets the dilution effect without fully shifting the downside to common shareholders. By contrast, full ratchet anti-dilution is more aggressive: it resets the conversion price of earlier preferred shares to the new, lower price, regardless of how many shares are issued. Both mechanisms preserve the economic position of preferred shareholders and shift dilution risk onto holders of common stock, typically founders and employees, who are most affected by the resulting increase in the fully diluted share count. *See. e.g.,* Derek Colla, *What You Need to Know About Down Round Financings*, Cooley GO (Jan. 24, 2022), https://www.cooleygo.com/down-round-financings. [↑](#footnote-ref-64)
65. *See* Steven N. Kaplan & Per Strömberg, *Financial Contracting Theory Meets the Real World: An Empirical Analysis of Venture Capital Contracts*, 70 Rev. Econ. Stud. 281, 282 (2003) (“In general, board rights, voting rights, and liquidation rights are allocated such that if the firm performs poorly, the VCs obtain full control. As performance improves, the entrepreneur retains/obtains more control rights. If the firm performs very well, the VCs retain their cash flow rights but relinquish most of their control and liquidation rights.”). [↑](#footnote-ref-65)
66. *See supra* note 8 and accompanying text. [↑](#footnote-ref-66)
67. *See* Kaplan & Strömberg, *supra* note 65. [↑](#footnote-ref-67)
68. *See* Thomas Hellmann, *The Allocation of Control Rights in Venture Capital Contracts*, 29 Rand J. Econ. 57 (1998). [↑](#footnote-ref-68)
69. *See* D. Gordon Smith, *The Exit Structure of Venture Capital*, 53 UCLA L. Rev. 315, 337 (2005) (emphasizing that “rather than leaving control up for grabs, venture capitalists and entrepreneurs bargain explicitly for control through a combination of express allocation provisions and voting rights,” highlighting the ex-ante nature of these arrangements and their role in avoiding future disputes). [↑](#footnote-ref-69)
70. Regarding hold-up risks, *see* Oliver Hart, *Financial Contracting*, 39 J. Econ. Lit. 1079, 1084–90 (2001) (explaining how incomplete contracts create hold-up problems when parties’ relative bargaining positions change, making ex ante control allocation essential for efficient outcomes). [↑](#footnote-ref-70)
71. *See* Josh Lerner, *Venture Capitalists and the Oversight of Private Firms*, 50(1) J. FIN. 301, 318 (1995) (providing direct evidence that board composition shifts based on performance triggers); Brian Broughman & Jesse M. Fried, *Do Founders Control Start-up Firms That Go Public?*, 10 Harv. Bus. L. Rev. 49 (2020); Will Gornall & Ilya A. Strebulaev, *The Contracting and Valuation of Venture Capital-Backed Companies*, in Handbook of the Economics of Corporate Finance, Vol. 1: Private Equity and Entrepreneurial Finance 33–60 (B. Espen Eckbo, Gordon M. Phillips & Morten Sorensen eds., 2023). [↑](#footnote-ref-71)
72. *See* Sahlman, *supra* note 56 at 503-10 (exploring control mechanisms in venture investing and startup governance); Yifat Aran & Elizabeth Pollman, *Ousted*, 25 Theoretical Inquiries L., 231, 237–38 (2024). [↑](#footnote-ref-72)
73. *See* Jennifer S. Fan, *The Landscape of Startup Governance in the Founder-Friendly Era*, 18 N.Y.U. J.L. & Bus. 317, 327–28 (2022); *See* Josh Lerner, *Venture Capital in a Time of Turmoil*, *in* Financiación Empresarial Y Emprendimiento, at 17 (2024) (arguing that the rise of “founder friendly” terms in VC deals can be attributed to increased competition among VCs for access to potentially high-return startups in a landscape where returns are heavily skewed toward a few successful deals); *see also* Brian J. Broughman & Matthew T. Wansley, *Risk-Seeking Governance*, 76 Vand. L. Rev. 1299, 1305 (2023) (“VCs with founder-friendly reputations gain a competitive advantage in ex ante pricing when contracting with risk-averse founders”). [↑](#footnote-ref-73)
74. *See* Mario Gabriele, *Founders Fund: The Disciples*, The Generalist (June 4, 2024), https://www.generalist.com/p/founders-fund-2. [↑](#footnote-ref-74)
75. *See e.g.,* Eric Ries, *Foreword*, in Kupor, *supra* note 38 at xi (“Possibly for the first time in history, we’re talent-constrained instead of capital-constrained.”); Vijay Govindarajan et. al., *Why We Need to Update Financial Reporting for the Digital Era*, Harv. Bus. Rev. (June 8, 2018), https://hbr.org/2018/06/why-we-need-to-updatefinancial-reporting-for-the-digital-era (arguing that in digital companies “[f]inancial capital is assumed to be virtually unlimited, while certain types of human capital are in short supply” and “[t]he CEO’s principal aim therefore is not necessarily to judiciously allocate financial capital but to allocate precious scientific and human resources to the most promising projects”). On the growing importance of human capital in corporate and securities law, *see* George S. Georgiev, *Human Capital Disclosure & Corporate Governance: The New Evidence*, 46 Cardozo L. Rev. 485, 488 (2024)*.* [↑](#footnote-ref-75)
76. *See* Rajan & Zingales, *supra* note 13 at 3 (“human capital is inalienable, and power over it has to be obtained through mechanisms other than ownership”); Courts are reluctant to order specific performance of labor contracts. *See* Paul H. Rubin & Peter Shedd, *Human Capital and Covenants Not to Compete*, 10 J. Lelal Stud. 93, 94 (1981) (“It is an old and well-established principle of law . . . that courts will generally not order specific performance…”); Eric A. Posner et al., *Investing in Human Capital: The Efficiency of Covenants Not to Compete* 1 (Univ. of Va. Law Sch., John M. Olin Program in Law & Econ. Working Paper No. 11, 2004) (employees cannot credibly commit to not leaving their employers because they can always default and file for bankruptcy). [↑](#footnote-ref-76)
77. *See* Cal. Bus. & Prof. Code § 16600 (West 2024) (“Except as provided in this chapter, every contract by which anyone is restrained from engaging in a lawful profession, trade, or business of any kind is to that extent void”); Edwards v. Arthur Andersen LLP, 189 P.3d 285, 297 (Cal. 2008) (“Noncompetition agreements are invalid under section 16600 in California even if narrowly drawn, unless they fall within the applicable statutory exceptions…”). The exceptions permit “noncompetition agreements in the sale or dissolution of corporations, partnerships, and limited liability corporations.” Edwards, 189 P.3d at 290–91; see also Cal. Bus. & Prof. Code §§ 16601–16602.5. [↑](#footnote-ref-77)
78. *See* Gary S. Becker, Human Capital: A Theoretical and Empirical Analysis, with Special Reference to Education 19 (3d ed. 1994). [↑](#footnote-ref-78)
79. *Id* at 17. [↑](#footnote-ref-79)
80. *Id* at 16–37. [↑](#footnote-ref-80)
81. *Id* at 33–34. [↑](#footnote-ref-81)
82. *Id* 33–35 (“general training”), *cf.* 40–41 (“specific training”). [↑](#footnote-ref-82)
83. *Id*; *See* alsogenerally Oliver E. Williamson, The Economic Institutions of Capitalism: Firms, Markets, Relational Contracting 76–77 (1985) (discussing the hold-up problem in bilateral trading relationships where specific investments create mutual dependence). In the context of labor relations, *see e.g.,* Paul A. Grout, *Investment and Wages in the Absence of Binding Contracts: A Nash Bargaining Approach* 52(2) Econometrica 449, 450 (1984) (demonstrates the classic employee hold-up problem: once the firm makes irreversible investments in capital, workers can renegotiate for higher wages knowing the firm is “locked in” to its investment); Margaret Stevens, *A Theoretical Model of On-the-Job Training with Imperfect Competition*, 46 Oxford Econ. Papers 537 (1994) (adds to Becker’s theory by arguing that when firms have market power over workers (imperfect competition), companies can capture returns from general training). [↑](#footnote-ref-83)
84. *See e.g.,* Annalee Saxenian, Regional Advantage: Culture and Competition in Silicon Valley and Route 128, at 34–37, 54–55 (1994) (discussing the high rate of employee mobility in early Silicon Valley); Ajay Agrawal et al., *Roads and Innovation*, 99 Rev. Econ. & Stat. 417, 417 (2017) (“By increasing the circulation of people in a region, they are also likely to facilitate knowledge diffusion and spillovers”). [↑](#footnote-ref-84)
85. *See* Kenneth J. Arrow, *The Economic Implications of Learning by Doing*, 29 Rev. Econ. Stud. 155, 168 (1962) (identifying that learning-by-doing creates positive externalities because firms cannot fully capture the benefits of their investments, the knowledge gained spills over to benefit other firms, leading to under-investment in learning activities from a social perspective); Paul M. Romer, *Endogenous Technological Change*, 98 J. Pol. Econ. S71, S96 (1990) (a model of endogenous technological change where economic growth is driven by the intentional creation of new ideas and technologies through R&D investment, with knowledge spillovers occurring because ideas are non-rival goods that can be used by multiple firms simultaneously). *Cf*. Paul M. Romer, *Endogenous Technological Change*, 98 J. Pol. Econ. S71 (1990) (demonstrating that firms can capture sufficient returns from R&D investment through monopolistic competition, where market power stems from temporary excludability over the specific designs and the new goods they create, allowing them to charge prices above marginal cost even as the underlying knowledge generates spillovers that benefit other researchers and drive endogenous growth). [↑](#footnote-ref-85)
86. *See* Romer, *Endogenous Technological Change, supra* note 85;Ronald J. Gilson, *The Legal Infrastructure of High Technology Industrial Districts: Silicon Valley, Route 128, and Covenants Not to Compete*, 74 N.Y.U. L. Rev. 575, 586 (1999) (“These knowledge spillovers supercharge the innovative capacity of the district with renewed agglomeration economies, facilitating the development of new technologies that create a new industrial life cycle”). [↑](#footnote-ref-86)
87. *See* Aran, *supra* note 23, at 1254. [↑](#footnote-ref-87)
88. *See* Gilson, *supra* note 86, at 596 (“While it would be in the interest of the region’s firms collectively to facilitate employee mobility even at the expense of diluting the intellectual property of individual firms, it will be in the interest of any individual firm to impede the mobility of its own employees. Such a firm gets the benefit of the regionwide spillover of other firms’ intellectual property without incurring the cost of diluting its own. Some coordinating mechanism is necessary to achieve (and perhaps maintain) the equilibrium . . . .”). [↑](#footnote-ref-88)
89. *See* Orly Lobel, Talent Wants to Be Free: Why We Should Learn to Love Leaks, Raids, and Free Riding 64–69 (2013) (describing California’s approach to noncompete agreements as “zero tolerance” and arguing that this approach is the key to Silicon Valley’s success); Alan Hyde, *Should Noncompetes Be Enforced?*, Regulation, Winter 2010–2011, at 6, 7–8 (asserting that California’s ban on noncompete enforcement “must be part of the mix” that leads to the high employee mobility that distinguishes Silicon Valley). [↑](#footnote-ref-89)
90. *See* Aran, *supra* note 23; Richard A. Booth, *Give Me Equity or Give Me Death—The Role of Competition and Compensation in Silicon Valley,* 1 Entrepreneurial Bus. L.J. 265, 271 (2006) (speculating that California employers rely on equity-based compensation as a way to bind employees because noncompetes are not enforced); Abraham J. B. Cable, *Fool’s Gold: Equity Compensation & the Mature Startup*, 11 Va. L. & Bus. Rev. 615 (2016). [↑](#footnote-ref-90)
91. Crucially, these tools enable a selective form of labor market efficiency. *See infra* Part I.2.c. [↑](#footnote-ref-91)
92. *See* Kupor, *supra* note 38, at 103 (discussing aligning incentives via contingent shared ownership). [↑](#footnote-ref-92)
93. *See* *supra* note 30 and accompanying text. [↑](#footnote-ref-93)
94. *See* Joseph A. Schumpeter, Capitalism, Socialism and Democracy 81–87 (1943) (Schumpeter’s concept of “creative destruction” posits that entrepreneurs drive progress by dismantling outdated production structures, a process often initiated by founders’ visionary risk-taking). [↑](#footnote-ref-94)
95. *See* Clayton M. Christensen, The Innovator’s Dilemma: When New Technologies Cause Great Firms to Fail 13–14 (1997) (highlights how incumbents’ structural disincentives lead them to neglect disruptive technologies, creating opportunities for entrants willing to embrace speculative ventures). [↑](#footnote-ref-95)
96. *See* Thiel & Masters, *supra* note 10 at 35 (“The most contrarian thing of all is not to oppose the crowd but to think for yourself. Great companies are built on first principles, not on what’s fashionable or easy. And that requires founders who can see beyond the horizon, who aren’t afraid to be different.”) [↑](#footnote-ref-96)
97. *See* DLA Piper, Intellectual Property Basics for Startups: Patents, DLA Piper Accelerate, https://www.dlapiperaccelerate.com/knowledge/2017/intellectual-property-basics-for-startups-patents.html (“The most common mistake by startups is failing to obtain proper written assignments or licenses of intellectual property rights that are developed by the founders prior to the startup’s incorporation…”). The alternative structure, where founders retain IP ownership and grant exclusive licenses to the firm, would preserve founders’ individual bargaining power over critical assets, potentially undermining the commitment mechanism that IP assignment creates. [↑](#footnote-ref-97)
98. *See* Raghuram G. Rajan & Luigi Zingales, *Power in a Theory of the Firm*, 113 Q.J. Econ. 387 (1998) (arguing that firms create value by regulating access to critical resources, which motivates specific investments by granting power that is more contingent on making the right investments than ownership alone); Raghuram G. Rajan & Luigi Zingales, *The Firm as a Dedicated Hierarchy: A Theory of the Origins and Growth of Firms*, 116 Q.J. Econ. 805, 806 (2001) (“The greater the access a manager has, the more he can appropriate, and the more effectively he can compete.”). *Cf.* Mira Ganor, *Recoupling Founders with Their IP – Improving Innovation by Rationalizing IRC Section 351,* 44 J. Corp. L. 493 (2019). [↑](#footnote-ref-98)
99. *See e.g.,* Oreoluwa Onabowale, *Designing Equity and Incentive Models for Early-Stage Tech Ventures: Balancing Growth and Governance*, 16 World J. Advanced Res. & Rev. 1240, 1245 (2022). [↑](#footnote-ref-99)
100. *Id.*  [↑](#footnote-ref-100)
101. The importance of these protections becomes clear when considering the high rate of team instability, *see* Peter Walker & Kevin Dowd, *Founder Ownership Report 2025*, Carta (Jan. 21, 2025), https://carta.com/data/founder-ownership/ (“About 24% of 2-founder teams lose a founder by Year 4.”). [↑](#footnote-ref-101)
102. *Id*. *See also* Mallaby *supra* note 43 at 44-45 (examining the divergent approaches to founder dilution between Georges Doriot and Arthur Rock, the “father” of venture capital). [↑](#footnote-ref-102)
103. *Supra* Section I.1.c. [↑](#footnote-ref-103)
104. *See* *e.g.,* Daniel T. Janis, *Venture Capital Shareholder Agreements—More Attention Now, Less Heartache Later*, Bus. L. Today (May 2017), https://businesslawtoday.org/2017/05/venture-capital-shareholder-agreements-more-attention-now-less-heartache-later/. *See also* Wansley, *supra* note 61, at 175–82. [↑](#footnote-ref-104)
105. *See, e.g.,* Brian Broughman & Jesse M. Fried, *Do Founders Control Start-Up Firms That Go Public?*, 10 Harv. Bus. L. Rev. 49 (2020) (documenting control allocation at the IPO); *See also* Sammy Abdullah, *How to Maximize founder Equity at Exit*, Crunchbase (Apr. 26, 2023), https://about.crunchbase.com/blog/founder-equity/ (analyzing 104 tech companies at IPO and finding median founder ownership of 15% and average of 21%); *see also* Sammy Abdullah, Tech founder ownership data, Medium (Feb. 5, 2022), https://blossomstreetventures.medium.com/tech-founder-ownership-data-62f3c452c838 (expanded study of 198 tech companies showing similar results); Walker & Dowd, *supra* note 101. [↑](#footnote-ref-105)
106. *See* Zohar Goshen & Assaf Hamdani, *Corporate Control and Idiosyncratic Vision*, 125 Yale L.J. 560, 579, 584 (2016). [↑](#footnote-ref-106)
107. *See* Aran & Pollman, *supra* note72, at 236–38; Ofer Eldar, *Dual-Class IPOs: A Solution to Unicorn Governance Failure*, in Research Handbook on the Structure of Private Equity and Venture Capital (Broughman & de Fontenay eds., forthcoming 2024). [↑](#footnote-ref-107)
108. *See e.g.,* Lucian A. Bebchuk & Kobi Kastiel, *The Untenable Case for Perpetual Dual-class Stock*, 103 Va. L. Rev. 585-630 (2017). [↑](#footnote-ref-108)
109. *See* Wansley, *supra* note 61, at 173 (founder power often stems primarily from operational realities rather than formal control rights); *See* also*,* Brian Broughman & Jesse Fried, *Renegotiation of Cash Flow Rights in the Sale of VC-Backed Firms*, 95 J. Fin. Econ. 384 (2010) (documenting that venture capitalists’ liquidation preference payouts are often renegotiated); Brian J. Broughman & Jesse M. Fried, *Carrots and Sticks: How VCs Induce Entrepreneurial Teams to Sell Startups*, 98 Cornell L. Rev. 1319 (2013). [↑](#footnote-ref-109)
110. *See supra* Part I.2.a. [↑](#footnote-ref-110)
111. *See* Aran, *supra* note 23, at 1274–75; Daniel Bias, *Illiquid Equity, Labor Mobility, and Talent Allocation* (Swedish House of Finance Research Paper No. 21–27, 2021), https://papers.ssrn.com/sol3/papers.cfm?abstract\_id=3960342 (documenting empirically the lock-in effect of illiquid vested stock option grants on startup employees); Emil Lakkis, *Human Capital and IPO Timing* (Nov. 22, 2022) (unpublished manuscript), https://ssrn.com/abstract=4279154 (providing empirical evidence that startups delay IPOs to retain workers). [↑](#footnote-ref-111)
112. *See supra* notes 89–90 and accompanying text. [↑](#footnote-ref-112)
113. *See* Yifat Aran, *The RSU Time Bomb: Regulating Startup Equity Compensation in the Unicorn Era*, in Research Handbook on the Structure of Private Equity and Venture Capital (Broughman & de Fontenay eds., forthcoming 2024). [↑](#footnote-ref-113)
114. *See* Aran, *supra* note 23, at 1264. [↑](#footnote-ref-114)
115. *See* notes 99–101 and accompanying text. [↑](#footnote-ref-115)
116. *See* 26 US Code § 422(a)(2); Aran, *supra* note 23, at 1266 (discussing the implications of these out-of-pocket costs on startup employee mobility). [↑](#footnote-ref-116)
117. *See* Jason Pressman, *Why Option Refresh Grants Are Essential for Startup Recruiting and Retention*, Forbes (July 19, 2017), https://www.linkedin.com/pulse/why-option-refresh-grants-essential-startup-retention-jason-pressman/ [↑](#footnote-ref-117)
118. *See* Aran *supra* note 23, at 1264. [↑](#footnote-ref-118)
119. *See* Carta, Equity Refresh Grants: How to Incentivize & Retain Talent (July 23, 2024), https://carta.com/learn/equity/compensation/equity-refresh/. [↑](#footnote-ref-119)
120. *See* Aran *supra* note 23, at 1274–75. [↑](#footnote-ref-120)
121. *Id* at 1279–81. [↑](#footnote-ref-121)
122. *See* Aran, *supra* note 113. [↑](#footnote-ref-122)
123. 26 USC § 409A (2024). *See* also Gregg D. Polsky, *Fixing Section 409A: Legislative and Administrative Options*, 57 Vill. L. Rev. 635 (2012). [↑](#footnote-ref-123)
124. *See* Aran, *supra* note 113. [↑](#footnote-ref-124)
125. *Id.* [↑](#footnote-ref-125)
126. For scholarship arguing that employees systematically lack bargaining power and information in equity compensation arrangements*, see id;* Cable, *supra* note 90; Aran, *supra* note 23; Yifat Aran & Raviv Murciano-Goroff, *Equity Illusions*, 41 J.L. Econ. & Org. 196 (2025); Anat Alon-Beck, *Unicorn Stock Options—Golden Goose or Trojan Horse?,* 2019 Colum. Bus. L. Rev. 107 (2019); Anat Alon-Beck, *Bargaining Inequality: Employee Golden Handcuffs and Asymmetric Information*, 81 Md. L. Rev. 1165 (2021). *Cf.* Abraham Cable, *Stock Options of Adhesion*, 50 J. Corp. L. (forthcoming 2025) (arguing for a contrary perspective). [↑](#footnote-ref-126)
127. *See* Henry W. Chesbrough, Open Innovation: The New Imperative for Creating and Profiting from Technology (2003); Michael G. Jacobides, Carmelo Cennamo & Annabelle Gawer, *Towards a Theory of Ecosystems*, 39 Strategic Mgmt. J. 2255, 2265 (2018) (alignment with partners); Kristopher J. Petersen, Robert B. Handfield & Gary L. Ragatz, *Supplier Integration into New Product Development: Coordinating Product, Process and Supply Chain Design*, 23 J. Operations Mgmt. 371 (2005) (alignment with suppliers); Gary Dushnitsky & Michael J. Lenox, *When Do Incumbents Learn from Entrepreneurial Ventures? Corporate Venture Capital and Investing Firm Innovation Rates*, 26 Research Policy 753 (2005) (corporate venture capital); Arun Sundararajan, The Sharing Economy: The End of Employment and the Rise of Crowd-Based Capitalism 135–138 (2016) (discussing platform equity distribution to users). [↑](#footnote-ref-127)
128. *See supra* Part I.2.a. [↑](#footnote-ref-128)
129. *See* Ari Levy, *These Airbnb hosts earned more than $15,000 on Thursday after the company let them buy IPO shares*, CNBC (Dec. 10, 2020, 3:44 PM), https://www.cnbc.com/2020/12/10/airbnb-hosts-profit-from-ipo-pop-spreading-wealth-beyond-investors.html. [↑](#footnote-ref-129)
130. *See* Uber Techs., Inc., Registration Statement (Form 424B4) 4 (May 9, 2019), https://www.sec.gov/Archives/edgar/data/1543151/000119312519144716/d647752d424b4.htm [↑](#footnote-ref-130)
131. *See* Liz Gannes, *Reddit Raises $50 Million, Plans to Share Stock With Community Members,* Recode (Sept. 30, 2014, 9:30 AM), https://www.recode.net/2014/9/30/11631424/reddit-raises-50m-plans-to-share-stock-with-community-members. [↑](#footnote-ref-131)
132. *See* Jessica Bursztynsky, *Reddit Discloses Finances in IPO Filing, Will Let Influential Moderators and Users Buy Shares at Offering Price*, Variety (Feb. 22, 2024, 6:42 AM), https://variety.com/2024/digital/news/reddit-ipo-filing-users-buy-shares-offering-price-1235919736/. [↑](#footnote-ref-132)
133. *See* Maggie Fitzgerald, *Robinhood is earmarking 20% to 35% of its own IPO shares for customers. Why smaller investors should proceed with caution*, CNBC (July 2, 2021, 9:45 AM), https://www.cnbc.com/2021/07/02/robinhood-earmarks-some-of-its-own-ipo-shares-for-customers-smaller-investors-should-tread-carefully.html. [↑](#footnote-ref-133)
134. *See* Steven L. Schwarcz, N*ext-Generation Securitization: NFTs, Tokenization, and the Monetization of “Things”*, 103 B.U. L. Rev. 967 (2023); Nizan Geslevich Packin, *The Nexus of Gaming and NFTs: A Deep Dive Into the Future of Digital Interaction*, in The Cambridge Handbook on Law and Policy for NFTs (Nizan Geslevich Packin ed., forthcoming 2024). [↑](#footnote-ref-134)
135. For research on how corporations use corporate venture capital investments to access external innovation, create strategic value, and manage disruptive threat, *see* Thomas J. Chemmanur, Elena Loutskina & Xuan Tian, *Corporate Venture Capital, Value Creation, and Innovation*, 27 Rev. Fin. Stud. 2434, 2435–36 (2014); Gary Dushnitsky & Michael J. Lenox, *When Does Corporate Venture Capital Investment Create Firm Value?,* 21 J. Bus. Venturing 753, 754–55 (2006); Darian M. Ibrahim, *Corporate Venture Capital,* 24 U. Pa. J. Bus. L. 209, 210–11 (2021); Jennifer S. Fan, *Catching Disruption: Regulating Corporate Venture Capital*, 2018 Colum. Bus. L. Rev. 341, 345–46 (2018). [↑](#footnote-ref-135)
136. *See* Mark A. Lemley & Matt Wansley, *Coopting Disruption*, 105 B.U. L. Rev. 101, 105–06 (2025); Matthew Wansley, Samuel Weinstein & Brian J. Broughman, *No Exit* 100 N.Y.U. L. Rev. (forthcoming 2025), available at https://ssrn.com/abstract=5316792. Examples include Google’s acquisition of DeepMind in 2014 for approximately $500–650 million, Microsoft’s cumulative investment of up to $13 billion in OpenAI from 2019 to 2023, Meta’s $2 billion acquisition of Oculus in 2014, Amazon’s $8 billion investment in Anthropic from 2023 to 2024, and Google’s over $3 billion in investments and commitments to Anthropic through 2025. [↑](#footnote-ref-136)
137. *See* Lemley & Wansley, *supra* note 136, at 18–20, 34–35 (describing corporate VC investment structures and board participation). [↑](#footnote-ref-137)
138. Examples include Microsoft’s $650 million arrangement with Inflection AI in March 2024, hiring CEO Mustafa Suleyman, co-founder Karén Simonyan, and most of the 70-person team while licensing AI models; Google’s $2.7–$3 billion deal with Character.AI in August 2024, bringing co-founders Noam Shazeer, Daniel De Freitas, and approximately 20% of staff to advance AI research, alongside technology licensing; Amazon’s arrangements with Adept AI in June 2024, hiring CEO David Luan and key team members with AI technology licensing, and with Covariant in August 2024, hiring founders Pieter Abbeel, Peter Chen, Rocky Duan, and about 25% of staff while licensing robotics AI models; and Meta’s $14.3–$14.8 billion investment in June 2025 for a 49% nonvoting stake in Scale AI, with CEO Alexandr Wang joining to support AI efforts. In each case, the target companies maintained formal independence. These arrangements, as scholars have noted, represent strategic moves to co-opt innovation while avoiding regulatory scrutiny. *See* Wansley, Weinstein & Broughman, *supra* note 136, at 64–67. [↑](#footnote-ref-138)
139. *See* John F. Coyle & Gregg D. Polsky, *Acqui-Hiring*, 63 Duke L. J. 281, 283–84 (2013) (“the buyer’s primary motivation is to hire some or all of the startup’s software engineers. After the transaction, the buyer redeploys the newly hired talent onto its existing projects and jettisons the startup’s projects. These acquisitions are known in the tech world as ‘acqui-hires’.”). *See* also Andres Sawicki, *Buying Teams*, 38 Seattle U. L. Rev. 651 (2014). [↑](#footnote-ref-139)
140. *See* Jordan Novet, *Google hires Windsurf CEO Varun Mohan, others in $2.4 billion AI talent deal*, CNBC (July 11, 2025), https://www.cnbc.com/2025/07/11/google-windsurf-ceo-varun-mohan-latest-ai-talent-deal-.html, but note that Google’s selective hiring was followed by Cognition AI acquisition that may have made employees whole, Maxwell Zeff, *Cognition, maker of the AI coding agent Devin, acquires Windsurf*, TechCrunch (July 14, 2025), https://techcrunch.com/2025/07/14/cognition-maker-of-the-ai-coding-agent-devin-acquires-windsurf/ [↑](#footnote-ref-140)
141. *See supra* note 98 and accompanying text. [↑](#footnote-ref-141)
142. *See e.g*., Darian M. Ibrahim, *Debt as Venture Capital*, 2010 U. ILL. L. Rev. 1169. *Cf.* Ronald J. Gilson & David M. Schizer, *Understanding Venture Capital Structure: A Tax Explanation for Convertible Preferred Stock*, 116 Harv. L. Rev. 874, 902 (2003). [↑](#footnote-ref-142)
143. *See* *supra* Part I.1.c. [↑](#footnote-ref-143)
144. *See* *supra* Part I.2.b. [↑](#footnote-ref-144)
145. *See* *supra* Part I.2.c. [↑](#footnote-ref-145)
146. *See* *supra* Part I.2.d. [↑](#footnote-ref-146)
147. *See* Pollman *supra* note 15, at 159 (“Corporate law literature has also often characterized shareholders as homogeneous in their interests and has excluded employees from analysis, recognizing their relevance to the corporation in only contractual terms.”). [↑](#footnote-ref-147)
148. *see* Richard B. Freeman, Joseph R. Blasi & Douglas L. Kruse, Shared Capitalism at Work: Employee Ownership, Profit and Gain Sharing, and Broad-based Stock Options 4 (2010) (“We use the term “shared capitalism” to refer to a diverse set of compensation practices through which worker pay or wealth depends on the performance of the firm or work group.”) [↑](#footnote-ref-148)
149. *See* *supra* note 5 (defining success). [↑](#footnote-ref-149)
150. *See supra* note 33 and accompanying text. [↑](#footnote-ref-150)
151. *See* *supra* Part I.2.b. [↑](#footnote-ref-151)
152. *Id*. [↑](#footnote-ref-152)
153. *See* *supra* note 123 and accompanying text. [↑](#footnote-ref-153)
154. *See e.g.,* Wilson Sonsini Goodrich & Rosati, The Entrepreneurs Report: Private Company Financing Trends—Full-Year 2024, at 8 (2025), https://www.wsgr.com/a/web/iZwvLxct3Zo9BCZPab7oru/entrepreneurs-report-q4-2024.pdf (documenting increased use of investor-favorable terms in 2024's challenging capital environment, including senior liquidation preferences appearing in 29% of Series B and later financings, up from 26% in 2023); see also How Liquidation Preference Fuels Conflicts in Venture Capital, The VC Factory (Apr. 25, 2024), https://thevcfactory.com/liquidation-preference-conflicts-venture-capital/ (explaining that “[l]ate-stage VCs (Series C onward) must protect their downside due to a higher cost of capital and lower return expectations from any individual investment” and that “[h]igher multiples like 2x or 3x are less common but can also be negotiated, indicating that the Investor would receive two or three times their initial investment before others”). *See also* Liquidation Preferences: Standard & Non-Standard Terms, Carta (Apr. 25, 2024), https://carta.com/learn/equity/liquidity-events/liquidation-preferences/ (discussing standard vs. nonstandard terms). [↑](#footnote-ref-154)
155. *See e.g*., Peter Walker, *Option pools and AI teams*, Carta Data Minute Newsletter (June 5, 2024) (on file with author) (explaining that AI companies are creating larger option pools because “AI/ML engineers can still command some serious market premiums”). [↑](#footnote-ref-155)
156. *See, e.g.,* Kupor *supra* note 38, at 146 (“This dance between two competing interests—properly incentivizing an entrepreneur and minimizing the dilution for other shareholders—is a carefully choreographed one that recurs many times throughout the life cycle of the company.”). [↑](#footnote-ref-156)
157. *See* Adolf A. Berle & Gardiner C. Means, The Modern Corporation and Private Property 244–54. (10th ed. 2009) [↑](#footnote-ref-157)
158. *See* Jensen & Meckling, *supra* note 16. [↑](#footnote-ref-158)
159. *Id* at 308. [↑](#footnote-ref-159)
160. *Id*. [↑](#footnote-ref-160)
161. *See* Brian R. Cheffins, *What Jensen and Meckling Really Said About the Public Company*, in Research Handbook on Corporate Purpose and Personhood 13 (Elizabeth Pollman & Robert Thompson eds., 2021). *See also* Zohar Goshen & Richard Squire, *Principal Costs: A New Theory for Corporate Law and Governance*, 117 Colum. L. Rev. 767, 769 (2017); Blair & Stout, *supra* note 18, at 248–249. [↑](#footnote-ref-161)
162. *See e.g.,* Stephen M. Bainbridge, The Profit Motive 2 (2023). [↑](#footnote-ref-162)
163. *See* Frank H. Easterbrook & Daniel R. Fischel, The Economic Structure of Corporate Law 68 (1996) (presenting the thesis that shareholders as a residual claimants have an interest in increasing the value of the corporation); Bainbridge, *supra* note 162 at 129. [↑](#footnote-ref-163)
164. *Id*. [↑](#footnote-ref-164)
165. *See* Jill E. Fisch, *Measuring Efficiency in Corporate Law: The Role of Shareholder Primacy*, 31 J. Corp. L. 637, 656 (2006). [↑](#footnote-ref-165)
166. *See* William T. Allen, *Ambiguity in Corporation Law*, 22 Del. J. Corp. L. 894, 896–97 (1997); Jack B. Jacobs, *Does the New Corporate Shareholder Profile Call for a New Corporate Law Paradigm?*, 18 Fordham J. Corp. & Fin. L. 19, 21 (2012). [↑](#footnote-ref-166)
167. *See e.g*., Lucian A. Bebchuk & Roberto Tallarita, *The Illusory Promise of Stakeholder Governance*, 106 Cornell L. Rev. 91 (2020); Leo E. Strine, Jr. & Nicholas Walter, *Conservative Collision Course? The Tension Between Conservative Corporate Law Theory and Citizens United*, 100 Cornell L. Rev. 335, 339 (2015). *Cf*. Stephen M. Bainbridge, *Corporate Social Responsibility in the Night Watchman State*, 115 Colum. L. Rev. 39, 48 (2015). [↑](#footnote-ref-167)
168. Staged financing is interpreted through the lens of the principal-agent problem as a mechanism for investor oversight and loss mitigation in the face of information asymmetries. Paul Gompers, for example, found that the time between venture capital funding rounds tends to increase as startups accumulate tangible assets and the severity of asymmetric information declines. *See* *supra* note 56 and accompanying text. [↑](#footnote-ref-168)
169. *See* Gompers, *supra* note 56, at 1461. [↑](#footnote-ref-169)
170. *See* Paul Gompers & Josh Lerner, *The Venture Capital Revolution*, 15(2) J. Econ. Pers. 145, 156 (2001); Josh Lerner, *Venture Capitalists and the Oversight of Private Firms*, 50(1) J. Fin. 301 (1995). [↑](#footnote-ref-170)
171. *See e.g.,* Triantis, *supra* note 58, at 312. [↑](#footnote-ref-171)
172. *See e.g.,* Malcolm P. Baker & Paul A. Gompers, *Executive Ownership and Control in Newly Public Firms: The Role of Venture Capitalists* (Nov. 1999) (unpublished manuscript), https://ssrn.com/abstract=165173. (revealing that venture-backed startup CEOs have more performance-driven compensation structures, earning lower fixed salaries but receiving higher equity-based remuneration). [↑](#footnote-ref-172)
173. *See e.g.,* Jesse M. Fried & Mira Ganor, *Agency Costs of Venture Capitalist Control in Startups*, 81 N.Y.U. L. Rev. 967, 993–997 (2006) [↑](#footnote-ref-173)
174. *See e.g.*, Gompers & Lerner, *supra* note 164, at127–31. *See also* Manuel A. Utset, *Reciprocal Fairness, Strategic Behavior & Venture Survival: A Theory of Venture Capital-Financed Firms*, 2002 Wis. L. Rev. 45, 55-56 (2002) (reviewing the principal-agent literature in venture capital-backed firms, and depicting the venture capitalist as a principal who must navigate information asymmetries and mitigate opportunistic behavior by entrepreneurial agents). [↑](#footnote-ref-174)
175. *See e.g.,* Gordon D. Smith, *Team Production in Venture Capital Investing*, 24 J. Corp. L. 949, 950 (1999) (“In some ways, it is more like a partnership than a principal-agent relationship”). [↑](#footnote-ref-175)
176. *See supra* note 17 and accompanying text. [↑](#footnote-ref-176)
177. *See* Bartlett, *supra* note 15, at 63 (demonstrating that startup companies experience both horizontal conflicts, among different classes of shareholders, and vertical conflicts, between managers and agents, simultaneously). *See also* Pollman, *supra* note 15, at 179–96 (building on Bartlett’s insight and offering a taxonomy of characteristic conflicts of interest, both horizontal and vertical, across the life cycle of startup firms). [↑](#footnote-ref-177)
178. *See e.g.,* Igor Filatotchev, Steve Toms & Mike Wright, *The Firm’s Strategic Dynamics and Corporate Governance Life-Cycle*, 2 Int’l J. Managerial Fin. 256, 257, 260 (2006) (arguing that agency theory overemphasizes monitoring, while governance across the corporate life cycle increasingly focuses on enabling value creation. They suggest resource-based theories better capture the evolving roles of governance actors, such as independent directors who both oversee management and help attract investors or talent); Jonathan D. Arthurs & Lowell W. Busenitz, *The Boundaries and Limitations of Agency Theory and Stewardship Theory in the Venture Capitalist–Entrepreneur Relationship*, 28 Entrep. Theory & Prac. 145, 146 (2003) (noting that agency theory only applies when there is goal incongruence between the venture capitalist and the entrepreneur; when their goals align, the theory offers no explanatory power). *Cf.* Jensen & Meckling, *supra* note 16 at 309 (distinguish between a pure agency relationship and a cooperative relationship, such as a production team). [↑](#footnote-ref-178)
179. *See* Bartlett, *supra* note 15, at 63. *See also* Arthurs & Busenitz, *supra* note 172 at 148 (“it appears that the agency problem is not uniform throughout the life of a venture. As a result, agency theory is likely to vary in its usefulness in explaining the VC and entrepreneur behaviors”). [↑](#footnote-ref-179)
180. *See e.g.,* Smith, *supra* note 175. [↑](#footnote-ref-180)
181. *See* Blair & Stout, *supra* note 22; Blair & Stout, *supra* note 18. [↑](#footnote-ref-181)
182. *See* Armen A. Alchian & Harold Demsetz, *Production, Information Costs, And Economic Organization*, 62 (5) The Am. Econ. Ass’n 777, 786 (1972) (Production teams arise when collaboration’s added output exceeds the costs of managing and supervising the team). Alchian and Demsetz’s team production theory enriched Ronald Coase's theory of the firm, which explains firms’ existence through transaction cost efficiencies. *Cf.* Ronald H. Coase, *The Nature of the Firm*, 4(16) Economica 33 (1937). [↑](#footnote-ref-182)
183. *See* Alchian & Demsetz, *supra* note 182, at 779–80. [↑](#footnote-ref-183)
184. *Id* at 781-82. [↑](#footnote-ref-184)
185. *Id* at 786. [↑](#footnote-ref-185)
186. *See* Bengt Holmstrom, *Moral Hazard in Teams*, 13(2) Bell J. Econ. 324, 325 (1982) (highlighting that team production is costly to monitor and involves unobservable inputs). [↑](#footnote-ref-186)
187. *Id* at 325–328. [↑](#footnote-ref-187)
188. *Id* at 326-28. [↑](#footnote-ref-188)
189. *Id.* [↑](#footnote-ref-189)
190. *See supra* note 82 and accompanying text. [↑](#footnote-ref-190)
191. *See* Raghuram G. Rajan & Luigi Zingales, *Power in the Theory of the Firm*, 113(2) Q. J. Econ. 387, 392 (1998). [↑](#footnote-ref-191)
192. *Id* at 393-94 (asset ownership matters because it determines who has bargaining power when incomplete contracts need to be renegotiated, which affects people’s incentives to make specific investments in the first place.). *Cf. supra* note 70 and accompanying text. [↑](#footnote-ref-192)
193. *Id*. [↑](#footnote-ref-193)
194. *See e.g.* Margaret M. Blair & Lynn A. Stout, *Specific Investment and Corporate Law*, 7 Eur. Bus. Org. L. Rev. 473, 474 (2006) (“When corporate production requires more than one individual or group to make specific investments, problems of intrafirm opportunism arise if shareholders try to exploit each other's specific investments or try to exploit the specific investments of creditors, employees, customers, and other groups.”). [↑](#footnote-ref-194)
195. *Id* at 484, 489-90; *see* also Blair & Stout, *supra* note 22; Blair & Stout, *supra* note 18. [↑](#footnote-ref-195)
196. *Id* at 489 (“Corporations tend to be formed to pursue businesses that require large amounts of enterprise-specific assets… employees’ acquisition of knowledge, skills, and relationships uniquely useful to their present firm, and of little value to other potential employers, are investments in firm-specific “human capital.”). [↑](#footnote-ref-196)
197. *See* Smith, *supra* note 175. [↑](#footnote-ref-197)
198. *Id* at 966. [↑](#footnote-ref-198)
199. *Id* at 973 (“by setting the valuation, the lead investor acts in a manner similar to the principal described in the economic models discussed in Part IV above. She breaks the budget, not by appropriating all of the output for herself as envisioned by Holmstrom's model, but by allocating a share of the output to herself through discounted valuation”). *See* also *supra* Part I.1.c. [↑](#footnote-ref-199)
200. See Pollman, *supra* note 15 at 621. [↑](#footnote-ref-200)
201. *Id* at 635–638. *See* also *supra* Part I.1.d. [↑](#footnote-ref-201)
202. *Id* at 642. [↑](#footnote-ref-202)
203. *Id* at 645. *See* also *supra* Part I.2.c. and Part Part I.3. [↑](#footnote-ref-203)
204. *See* Smith, *supra* note 175 at 950 (“The task of analyzing venture capital contracts through the lens of team production is complicated by the fact that the relationship between entrepreneur and venture capitalist does not fit easily into existing economic models of team production. In short, their relationship is not “pure” team production”). [↑](#footnote-ref-204)
205. *See* Pollman, *supra* note 15 at 647 (“But the above discussion also shows that, for many private companies, the board of directors does not serve as a mediating hierarchy”.) [↑](#footnote-ref-205)
206. *See* Brian Broughman, Jesse M. Fried & Darian Ibrahim, *Delaware Law as Lingua Franca: Theory and Evidence*, 57 (4) J.L. & ECON. 865, 865 (2014). [↑](#footnote-ref-206)
207. *See* In re Trados Inc. Shareholder Litig., *supra* note 11, at 40–41. [↑](#footnote-ref-207)
208. *See* Abraham J.B. Cable, *A Decade of Trados*, in Research Handbook on the Structure of Private Equity and Venture Capital (Broughman & de Fontenay eds., forthcoming 2024). [↑](#footnote-ref-208)
209. *See* In re Trados Inc. Shareholder Litigation, 73 A.3d 17, 44–54 (Del. Ch. 2013), the Delaware Chancery Court found that six of the seven board members were conflicted: three were appointed by venture capital funds with interests in the merger, two were management directors with financial incentives tied to the transaction, and one “independent” director had economic ties and close relationships with a venture capital fund, undermining their impartiality. [↑](#footnote-ref-209)
210. *Id* at 50. [↑](#footnote-ref-210)
211. *See* Abraham J.B. Cable, *Opportunity-Cost Conflicts in Corporate Law*, 66 Case W. Res. L. Rev. 51, 52-57 (2015) (identifying the “opportunity-cost conflict” concept). [↑](#footnote-ref-211)
212. *See* In re Trados Inc. Shareholder Litig., *supra* note 11, at 113-114. [↑](#footnote-ref-212)
213. *Id* at 40–41 (“[G]enerally it will be the duty of the board, where discretionary judgment is to be exercised, to prefer the interests of the common stock . . . to the interests . . . of preferred stock.”). [↑](#footnote-ref-213)
214. *See* Strine, *supra* note 27, at 2028. [↑](#footnote-ref-214)
215. In re Nine Systems Corporation S'holders Litig., Consol. C.A. No. 3940-VCN (Del. Ch. Sept. 4, 2014). [↑](#footnote-ref-215)
216. In re Nine Sys. Corp. S'holders Litig., 2015 WL 2265669 (Del. Ch. May 7, 2015), (2016). [↑](#footnote-ref-216)
217. The Frederick Hsu Living Trust v. Oak Hill Capital Partners III, L.P., et al., C.A. No. 12108-VCL (Del. Ch. May 4, 2020). *See* also, Carsanaro v. Bloodhound Techs., Inc., 65 A.3d 618 (Del. Ch. 2013) which concluded with a settlement. [↑](#footnote-ref-217)
218. Frederick Hsu Living Trust v. Oak Hill Capital Partners, III, L.P., 2020 WL 2111476, at 80 (Del. Ch. May 4, 2020) (“Oversee’s common stock would have ended up worthless with or without the cash-accumulation strategy.”). See also Basho Technologies Holdco B, LLC v. Georgetown Basho Investors, LLC, 2018 WL 3326693 (Del. Ch. July 6, 2018) (applying entire fairness standard where controlling shareholder coerced acceptance of onerous financing terms after blocking alternative funding sources, reinforcing fiduciary obligations in controlling shareholder self-dealing transactions). [↑](#footnote-ref-218)
219. *Cf.*, Stephen M. Bainbridge, *Director Primacy: The Means and Ends of Corporate Governance*, 97 Nw. U. L. Rev. 547, 555 (2003) (arguing that Blair and Stout’s team production theory is inconsistent with boards duty to maximize value for shareholders under Delaware law). [↑](#footnote-ref-219)
220. *See* Blair & Stout, *supra* note 18, at 252 (“directors of public firms enjoy an extraordinary degree of discretion to pursue other agendas and to favor other constituencies, especially management, at shareholders’ expense.”). [↑](#footnote-ref-220)
221. *See* Bratton & Wachter, *supra* note 28, at 1886 (“*Trados*, by insisting on a preference for the common stock, holds out perverse incentives where maximizing for the common sacrifices enterprise value.”). [↑](#footnote-ref-221)
222. *Id* at 1887 (“Trados makes it harder for a venture capitalist in control to realize on its investment whatever the particular case’s value posture, thus creating holdup value for the common.”). [↑](#footnote-ref-222)
223. *See supra* note 28 and accompanying text. [↑](#footnote-ref-223)
224. *See* Bartlett, *supra* note 28, at 294 (“As a matter of private ordering, Trados's view of the board can be expected to induce investors to contract specifically for more events to address an unknown future rather than rely on board representation”). [↑](#footnote-ref-224)
225. *See* Sanga & Talley, *supra* note 28, at 25 (“The model demonstrates that a governance rule that requires the board to act in common shareholders’ interests… is frequently counterintuitive in structure and only sometimes efficient… [O]ur analysis suggests that mandating a common-choose governance rule generates direct economic costs that would need to be justified by indirect benefits. Such benefits are—in our estimation—sui generis and contingent.”). [↑](#footnote-ref-225)
226. *Id* (“By contrast, given a governance rule that requires the board to act in preferred shareholders’ interests… the standard expectation measure of damages always induces preferred shareholders to internalize common shareholders’ losses efficiently.”) [↑](#footnote-ref-226)
227. *Id* at 26. [↑](#footnote-ref-227)
228. *See* Abraham Cable, *Does Trados Matter?,* 45 J. Corp. L. 311, 327–30 (2020) (assessing that “the influence of Trados on ex ante contracts seems to be mild”). While the NVCA added a new “sale right” to address *Trados*, this provision has seen very limited adoption. Results regarding modifications to drag-along rights are mixed, with some lawyers reporting changes while others see no meaningful difference. *Id. See* also *supra* Part I.1.d. [↑](#footnote-ref-228)
229. *Id* at 313. [↑](#footnote-ref-229)
230. *See* Brian R. Cheffins, *The Team Production Model as a Paradigm*, 38 Seattle U. L. Rev. 397 (2015). [↑](#footnote-ref-230)
231. *See* Blair & Stout, *supra* note 22; Blair & Stout, *supra* note 18. *Cf.* Bainbridge, *supra* note 219, at 590 (“In fact, however, firm specific investments are not the defining characteristic of team production.”). [↑](#footnote-ref-231)
232. *See* Blair & Stout, *supra* note 194. [↑](#footnote-ref-232)
233. *See e.g.,* Cheffins, *supra* note 230; Bainbridge, *supra* note 219, at 590-92. [↑](#footnote-ref-233)
234. *See supra* Part I.2.a. [↑](#footnote-ref-234)
235. *See supra* note 76 and accompanying text. [↑](#footnote-ref-235)
236. Jensen & Meckling, *supra* note 16 at 308 (“Viewed in this light it is clear that our definition of agency costs and their importance to the theory of the firm bears a close relationship to the problem of shirking and monitoring of team production.”). [↑](#footnote-ref-236)
237. Investors can choose not to participate in a follow-on round; see supra note 57 and accompanying text. Founders and employees may quit; see Parts I.2.b and I.2.c. [↑](#footnote-ref-237)
238. *See supra* note 156 and accompanying text. [↑](#footnote-ref-238)
239. *See* Reid H. Hoffman et al., The Alliance: Managing Talent in the Networked Age 6 (2014) (outlining the shift toward at-will employment, where workers are expected to see themselves as autonomous agents and prioritize their own career interests); Aran, *supra* note 23 at 1243-44. [↑](#footnote-ref-239)
240. *See supra* note 211 and accompanying text. [↑](#footnote-ref-240)
241. *See* William R. Kerr, Ramana Nanda & Matthew Rhodes-Kropf, *Entrepreneurship as Experimentation*, 28 J. Econ. Persps. 25, 38 (2014) (“Innovation requires running experiments that will often fail.”); *see also* Elizabeth Pollman, *Startup Failure*, 73 Duke L.J. 327, 366 (2023) (discussing the advantages of Silicon Valley’s approach to startup failures which is to normalize failure and redeploy the resources); Gustavo Manso, *Motivating Innovation*, 66 J. Fin. 1823, 1824 (2011) (showing that incentive structures designed with tolerance for early failure and reward for long-term success are most effective in motivating innovation). *See* also *supra* note 30. [↑](#footnote-ref-241)
242. *See* *supra* Part I.2.a. [↑](#footnote-ref-242)
243. *See* Pollman *supra* note 5. [↑](#footnote-ref-243)
244. *See supra* Part I.1.c. [↑](#footnote-ref-244)
245. *See supra* Part I.2.b. *See* also *supra* notes 191-93 and accompanying text. [↑](#footnote-ref-245)
246. *See supra* notes 186-87 and accompanying text. [↑](#footnote-ref-246)
247. *See* Blair & Stout, *supra* note 22 at 747. [↑](#footnote-ref-247)
248. *See* Part II.2. [↑](#footnote-ref-248)
249. *See supra* Part I.2.b. (founders) and Part I.2.c. (employees). [↑](#footnote-ref-249)
250. *See* Bainbridge, *supra* note 219. *See* also Daniel R. Fischel, *Labor Markets and Labor Law Compared with Markets and Corporate Law*, 51(4) Univ. Chi. L. Rev. 1061, 1067 (1984) (“The possibility of firm-specific investments of human capital in labor markets raises a somewhat different problem. It suggests that although labor markets may be competitive at the time of the original negotiation, they may not remain competitive after one of the parties becomes dependent on the other ... Workers in competitive labor markets realize this possibility, however, and demand compensation ex ante.”). [↑](#footnote-ref-250)
251. *See supra* Part I.1.b. [↑](#footnote-ref-251)
252. *See supra* Part I.2.c. and Part II.2. [↑](#footnote-ref-252)
253. *See supra* notes 221-25 and accompanying text. [↑](#footnote-ref-253)