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Specific Investments, Opportunism and Corporate Contracts: A Theory of Tag-along and Drag-along Clauses

Articles | Published: 28 February 2015

Volume 11, pages 423–458, (2010) [Cite this article](#)

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Abstract

This paper is designed to analyse the effectiveness of tag-along and drag-along arrangements. These are of widespread use in corporate reality, in particular among private companies. And yet, despite their recurrence in normal practice, they have not to date attracted the interest of the legal literature. The paper intends to confirm the validity of three essential intuitions about these arrangements that redefine the ordinary understanding of them. The first is that they constitute ‘anti-opportunism’ mechanisms inasmuch as they are arrangements in principle designed to respond to ex post conflicts of interest between liquidity and stability. They are, then, contractual tools that aim to

protect one shareholder from opportunistic behaviour on the part of another in companies where both have made heavy specific investments. These clauses are particularly pertinent in settings such as joint ventures or venture capital companies, which tend to involve such investments. The second intuition is that these arrangements constitute self-defence tools that are, additionally, relatively self-enforceable. Specifically, self-defence adopts the form of a put option in tag-along arrangements or a call option in drag-along arrangements, to the benefit of shareholders exposed to expropriation risk. These tools are relatively self-enforceable because their implementation entails no third-party involvement. The third intuition is that their typical location is that of shareholders' agreements and not bylaws, since they define inter-shareholder relations (involving all or some of them) rather than corporate structure or machinery.

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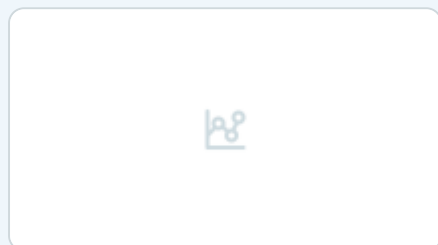
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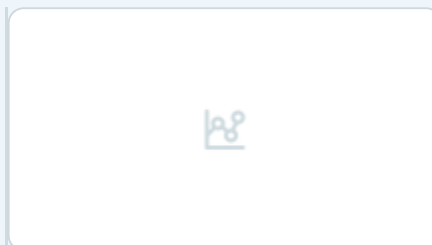
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The authors wish to thank Cándido Paz-Ares, Jesús Alfaro, Fernando Gómez and Stefano Lombardo for their helpful comments. We also thank the audience of the EALE 2006. This research is supported by a research grant from the Ministerio de Ciencia e Innovación (DER 2008-04779/JURI).

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Cite this article

Lacave, M.I.S., Gutierrez, N.B. Specific Investments, Opportunism and Corporate Contracts: A Theory of Tag-along and Drag-along Clauses. *Eur Bus Org Law Rev* 11, 423–458 (2010).

<https://doi.org/10.1017/S1566752910300061>

Published

28 February 2015

DOI

<https://doi.org/10.1017/S1566752910300061>

Issue date

September 2010

Keywords

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