

University of Pennsylvania Carey Law School

Penn Law: Legal Scholarship Repository

Faculty Scholarship at Penn Law

2014

Value Creation by Business Lawyers: Where Are We and Where Are We Going

Elizabeth Pollman

University of Pennsylvania Carey Law School

Follow this and additional works at: https://scholarship.law.upenn.edu/faculty_scholarship



Part of the [Business Organizations Law Commons](#), [Law and Economics Commons](#), and the [Legal Profession Commons](#)

Repository Citation

Pollman, Elizabeth, "Value Creation by Business Lawyers: Where Are We and Where Are We Going" (2014). *Faculty Scholarship at Penn Law*. 2561.

https://scholarship.law.upenn.edu/faculty_scholarship/2561

This Article is brought to you for free and open access by Penn Law: Legal Scholarship Repository. It has been accepted for inclusion in Faculty Scholarship at Penn Law by an authorized administrator of Penn Law: Legal Scholarship Repository. For more information, please contact PennlawIR@law.upenn.edu.

VALUE CREATION BY BUSINESS LAWYERS: WHERE ARE WE AND WHERE ARE WE GOING?

ELIZABETH POLLMAN*

ABSTRACT

This is a transcript of Professor Elizabeth Pollman’s remarks for the “Value Creation by Business Lawyers in the 21st Century” panel at the 2014 AALS Annual Meeting. The panel commemorated the 30th anniversary of Ronald Gilson’s article, *Value Creation by Business Lawyers: Legal Skills and Asset Pricing*. Professor Pollman’s remarks examined the influence of the Gilson article and potential areas for future work in light of regulatory and technological changes affecting transactional lawyering as well as the rise of in-house counsel.

TABLE OF CONTENTS

I. INTRODUCTION	13
II. WHERE ARE WE?.....	15
III. WHERE ARE WE GOING?	19

I. INTRODUCTION

I’m delighted to participate in celebrating the 30th anniversary of Professor Ron Gilson’s groundbreaking article, *Value Creation by Business Lawyers: Legal Skills and Asset Pricing*.¹ Professor Gilson’s ideas, and the questions he posed in this seminal article, have had remarkable staying power. On a personal note, as an alumna of Stanford Law School, I feel I directly benefited from some of the important ideas in Professor Gilson’s article, as I had the opportunity to take coursework in corporate theory, deals, and finance, and was exposed to the idea that business lawyers could expand the pie—that is, increase the value of a transaction net of legal fees.² My brief comments today

* Associate Professor of Law, Loyola Law School, Los Angeles. Thanks to Eric Gouvin, Therese Maynard, and Afra Afsharipour for organizing and moderating this panel at the 2014 Annual Meeting of the Association of American Law Schools (AALS).

¹ Ronald J. Gilson, *Value Creation by Business Lawyers: Legal Skills and Asset Pricing*, 94 *YALE L.J.* 239 (1984).

² *Id.* at 243.

examine the influence of Professor Gilson's article and offer some modest thoughts for the future.

Fundamentally, the *Value Creation* article asked two core questions: what do business lawyers do and do they increase the value of the transaction?³ In identifying the value-enhancing activities of business lawyers, Professor Gilson took the perspective of overall transaction value—transactional lawyering that expands the pie rather than simply distributes it. He attempted to evaluate whether there is a “purely private ordering” role for business lawyers because of his observation at the time that “business lawyers frequently function in a world in which regulation has made few inroads.”⁴ That is, he didn't rely on how lawyers might minimize regulatory interference in showing how business lawyers create value.

With these goals, and the acknowledgement of measurement problems, Professor Gilson hypothesized that business lawyers might create value by acting as “transaction cost engineers.”⁵ Specifically, he looked to the assumptions on which capital asset pricing theory relies, that there are no transaction costs or informational disparities and that parties have the same expectations and time horizons.⁶ He then suggested business lawyers might create value by minimizing these real-world deviations to bring transactions, which are the transfer of capital assets, closer to the economic model of pricing accuracy.⁷ In other words, business lawyers create value by providing “a transactional structure which reduces transaction costs and therefore results in more accurate asset pricing.”⁸ He thus linked transaction cost economics with his transaction cost engineer concept, asserting further that business lawyers are the primary players who can design structures and mechanisms to create transaction value.⁹ He tested this hypothesis by “reading the tracks that were left” by business lawyers in a corporate acquisition agreement, finding earn-out provisions, representations and warranties, and opinions of counsel, for instance, as examples of lawyers remedying market failures and creating value.¹⁰

Finally, he examined the implications of these ideas for the legal profession and legal education. Why have lawyers dominated the transaction cost

³ *Id.* at 241-43.

⁴ *Id.* at 247.

⁵ *Id.* at 247-48, 253.

⁶ *Id.* at 252-54.

⁷ *Id.* at 254-55. The basic idea of the capital assets pricing model is that in an efficient market assets will be valued by their expected return and systematic risk. *Id.*

⁸ *Id.* at 255.

⁹ *Id.*

¹⁰ *Id.* at 256. Part of this explanation also engaged with the idea of lawyers as reputational intermediaries, building on important contemporaneous work by Professor Gilson and Professor Reinier Kraakman. *Id.* at 289-90 (citing Ronald J. Gilson & Reinier H. Kraakman, *The Mechanisms of Market Efficiency*, 70 VA. L. REV. 549 (1984)).

Ed. 1] *Value Creation by Business Lawyers: Where Are We and Where Are We Going?* 15

engineer role and how does the profession remain competitive vis-à-vis other professions like banking and accounting? Here, Professor Gilson reintroduced the existence of regulatory influences to explain the dominance of lawyers as transaction cost engineers, and asserted that if business lawyers understood their function better, they'd be better at it and more successful in competing with other professions.¹¹ As for legal education, the article suggested teaching theory of private ordering through finance and transaction cost economics in order to facilitate practice.¹²

II. WHERE ARE WE?

One of the best ways I can think of to commemorate and honor Professor Gilson's *Value Creation* article is to examine its influence. As John Quincy Adams said, "If your actions inspire others to dream more, learn more, do more and become more, you are a leader." By this measure, and no doubt by others, Professor Gilson has surely been a leader. He wrote about what business lawyers do at a time when others weren't devoting much attention to this part of the legal profession or this type of inquiry. This is one thing that has certainly changed in the past 30 years. Many scholars have since been inspired to expand upon Professor Gilson's narrative of the role of business lawyers and the value they add. At the same time, scholars have also challenged aspects of the value creation story, which has also lead to further insights. And, of course, particularly in recent years, legal academics have more deeply engaged in debate on the future of legal education, including how to effectively train business lawyers. It's these areas of development or influence that I'd like to briefly touch upon before attempting to add a little food for thought. I'll loosely categorize the areas as: (1) literature that expands or updates the value creation paradigm, (2) literature on regulation and value creation, (3) negotiation theory literature, and (4) literature on business law education.

First, one broadly-construed line of literature has expanded or updated the value-creation model, such as by adding an understanding of the importance of reputation, legal system costs, relational contracting, and additional perspectives such as a sociological lens.¹³ My co-panelist, Professor Karl Okamoto expanded upon the idea of business lawyers as reputational intermediaries between their clients and third parties, highlighting the importance of reputation as a source of

¹¹ Gilson, *supra* note 1, at 301.

¹² *Id.* at 303-06.

¹³ Relational contracting refers to contracts entered into with the expectation of an ongoing relationship and the idea that the prospect of future exchanges will shape parties' interactions. *See, e.g.*, Charles J. Goetz & Robert E. Scott, *Principles of Relational Contracts*, 67 VA. L. REV. 1089 (1981); Ian R. MacNeil, *The Many Futures of Contracts*, 47 S. CAL. L. REV. 691 (1974).

value in business practice.¹⁴ Edward Bernstein, a practicing business lawyer, has argued that it is unrealistic to ignore “legal system” costs.¹⁵ In practice, parties have to deal with delay, litigation and enforcement costs, and deviations from anticipated outcomes. Professor Lisa Bernstein, building on the work of sociologist Mark Suchman, observed that the economic perspective of transactional lawyering could be fruitfully supplemented by sociological findings, and that the Silicon Valley lawyer, who plays multiple legal and extralegal roles in a relational contracting setting, could be understood as an example of a transaction cost engineer.¹⁶ Further, she concluded that this sociological lens provided a lesson for business lawyers that “failure to consider the existence of extralegal and social norm-based constraints on behavior” could lead them to make the mistake of “overlawyering” transactions.¹⁷

Mark Suchman’s work has added interdisciplinary texture to understanding what Silicon Valley business lawyers do—they don’t simply assist in isolated transactions, but rather are part of constructing the cultural context itself in which these transactions are “comprehensible, desirable, feasible, and meaningful.”¹⁸ Professor Suchman suggests that a sociological account of the Silicon Valley business lawyer could support the transaction-cost engineer paradigm, but notes that what is seen as “value creation” activity might instead be lawyers acting as “touts and bouncers for the prevailing legal regime.”¹⁹ My co-panelist, Professor Jeff Lipshaw, has similarly suggested the alternative explanation that business lawyers have cultural significance and are part of the ritual of business transactions.²⁰ Along the lines of work that improves our understanding of what Silicon Valley or start-up lawyers do, Paul Gompers and Josh Lerner have elucidated how lawyers have engineered structures and contracting forms to accommodate client needs in the venture capital space.²¹

¹⁴ Karl S. Okamoto, *Reputation and the Value of Lawyers*, 74 OR. L. REV. 15 (1995).

¹⁵ Edward Bernstein, *Law & Economics and the Structure of Value Adding Contracts: A Contract Lawyer’s View of the Law & Economics Literature*, 74 OR. L. REV. 189, 198 (1995).

¹⁶ Lisa Bernstein, *The Silicon Valley Lawyer as Transaction Cost Engineer?*, 74 OR. L. REV. 239 (1994) (discussing and building upon Mark C. Suchman, *On Advice of Counsel: Law Firms and Venture Capital Funds as Information Intermediaries in the Structuration of Silicon Valley* (1994) (unpublished Ph.D. thesis, Stanford University) (on file with Robert Crown Law Library at Stanford University)).

¹⁷ *Id.* at 255.

¹⁸ Mark C. Suchman, *Translation Costs: A Comment on Sociology and Economics*, 74 OR. L. REV. 257, 263-64 (1995).

¹⁹ *Id.* at 267-68.

²⁰ Jeffrey M. Lipshaw, *Beetles, Frogs, and Lawyers: The Scientific Demarcation Problem in the Gilson Theory of Value Creation*, 46 WILLAMETTE L. REV. 139, 140-41 (2009).

²¹ PAUL GOMPERS & JOSH LERNER, *THE VENTURE CAPITAL CYCLE* (2d ed. 2004); see also Steven Kaplan & Per Stromberg, *Financial Contracting Theory Meets the Real World: An Empirical Analysis of Venture Capital Contracts*, 70 REV. ECON. STUD. 281 (2003).

Ed. 1] *Value Creation by Business Lawyers: Where Are We and Where Are We Going?* 17

Others scholars, like Professor George Dent, have also offered broader analyses of what business lawyers do. He has discussed business lawyers as “enterprise architects,” pointing out that much of what business lawyers do is not transactions like mergers and acquisitions (M&A), but rather relational contracts, strategic alliances, and internal transactions such as reorganizations, financings, and executive employment contracts, as well as advisory and compliance work.²² Scholars like Brian Quinn, Steven Davidoff Solomon, and Christina Sautter have also built on Professor Gilson’s work, perhaps not explicitly framed as extensions, but by adding to the literature on deal structures and terms. They have done the important work of studying the tracks of the beetles themselves, such as by “describing the good and the bad of transactional lawyering” in the context of private equity,²³ and examining how business lawyers handle contracting obstacles such as asset-specific investments and specific deal provisions.²⁴ Professors Gordon Smith and Brayden King have added organizational theories (resource, learning, identity, and institutional theory) “to supplement—and in some instances, perhaps, challenge” economic accounts, showing that business lawyers serve multiple purposes and have multiple ways of creating value.²⁵

Here it’s worth noting, as Professor Gilson did today, that a line of literature has challenged finance theory such as the capital assets pricing model and the underpinnings of rational economic decisionmaking—for example, literature showing that asset value may be affected by noise, network effects, information cascades, or other factors.²⁶ Scholars such as Professor Robert Thompson have noted, building on Professor Gilson’s work, that this has created the potential for additional insights for lawyering, such as that lawyers in a positive feedback economy may add value by paying attention to the timing of deals.²⁷

Second, a line of literature has shown that regulation is a rich area of study and an important realm for broadening our understanding of what business lawyers do, particularly as the administrative state has increased substantially in

²² George W. Dent, Jr., *Business Lawyers as Enterprise Architects*, 64 *BUS. LAW.* 279, 286-95 (2009).

²³ Steven M. Davidoff, *The Failure of Private Equity*, 82 *S. CAL. L. REV.* 481, 486 (2009).

²⁴ See, e.g., Christina M. Sautter, *Auction Theory and Standstill Agreements: Dealing with Friends and Foes in a Sale of Corporate Control*, 64 *CASE W. RES. L. REV.* 521 (2013); Steven M. Davidoff & Christina M. Sautter, *Lock-Up Creep*, 38 *J. CORP. L.* 681 (2013); Brian J.M. Quinn, *Asset Specificity and Transaction Structures: A Case Study of @Home Corporation*, 15 *HARV. NEGOT. L. REV.* 77 (2010).

²⁵ D. Gordon Smith & Brayden G. King, *Contracts as Organizations*, 51 *ARIZ. L. REV.* 1, 2 (2009).

²⁶ Robert B. Thompson, *Value Creation by Lawyers Within Relational Contracts and in Noisy Environments*, 74 *OR. L. REV.* 315, 316 (1995).

²⁷ *Id.* at 324-25.

the past few decades. Professor Steven Schwarcz's empirical work, which surveyed transactional lawyers and their clients, challenged the idea of transactional lawyers as "transaction cost engineers" or "reputational intermediaries," by suggesting that transactional lawyers primarily add value by reducing regulatory costs.²⁸ This work couldn't be provided by just any kind of professional; it requires legal training. Professor Schwarcz asserts this may help explain why business lawyers are concentrated in transaction-regulatory areas such as securities law, M&A, banking, structured finance, and project finance, and why "transactional lawyers are (and should be) secure in their professions."²⁹

Professor Victor Fleischer has shown that regulatory arbitrage—structuring a deal to avoid regulatory costs without unduly changing the substance of the underlying economics—should be added to our understanding of what business lawyers do, in addition to deal quarterbacking and acting as transaction-cost engineers.³⁰ Professor Fleischer's work adds depth and complexity to the tradeoff between engineering transaction costs and regulatory costs that Professor Gilson earlier identified—this helps Professor Gilson's *Value Creation* framework better fit with what we observe in real-world deals which aren't always efficiently structured to minimize transaction costs.³¹ As Professor Fleischer has described, "deal lawyers engineer regulatory costs as well as Coasean transaction costs, balancing the two against the shifting backdrop of legal, business, ethical, professional, and political concerns."³² Adding regulatory arbitrage to the mix raises the possibility that some of what business lawyers do might create value for their clients but reduce overall social welfare because some regulatory arbitrage could be viewed as a transfer from the state to private clients, perhaps particularly those who are wealthy, sophisticated, and politically well-connected.³³

Professor Nestor Davidson's work has added that the government may be "more than a neutral referee" and that clients may seek value beyond economic metrics.³⁴ His focus is the public-private transactional context, in which lawyers perform what he terms "regulatory translation"—that is, translating abstract policy goals into private ordering mechanisms.³⁵ The key point he adds is the notion that transactional lawyers in this context play a role in pursuing non-economic goals for their clients and thus the concept of value should

²⁸ Steven L. Schwarcz, *Explaining the Value of Transactional Lawyering*, 12 STAN. J.L. BUS. & FIN. 486 (2007).

²⁹ *Id.* at 506-07.

³⁰ Victor Fleischer, *Regulatory Arbitrage*, 89 TEX. L. REV. 227, 229-35 (2010).

³¹ *Id.* at 231-32.

³² *Id.* at 236.

³³ *See id.* at 234, 280-83, 288.

³⁴ Nestor M. Davidson, *Values and Value Creation in Public—Private Transactions*, 94 IOWA L. REV. 937, 941 (2009).

³⁵ *Id.* at 937.

Ed. 1] *Value Creation by Business Lawyers: Where Are We and Where Are We Going?* 19

correspondingly expand as these lawyers “hold the potential not only to make the pie bigger, but to help bake a very different pie.”³⁶

Third, literature has developed in negotiation theory, by Professor Robert Mnookin and many others, that adds important insights into the negotiation process through which value might be created and the strategic behavior, psychological barriers, and other obstacles that might lead to negotiation failure.³⁷

Fourth, and finally, literature and debate on transactional and business law education has largely expanded and been inspired by the *Value Creation* article we’re commemorating today.³⁸ This is likely an area with which many in the audience are familiar and others on the panel will be speaking about, so with apologies to those whose work there isn’t time to highlight today, I’ll turn now to the last portion of my comments.

III. WHERE ARE WE GOING?

One of the key lasting ideas of the *Value Creation* article is to bring academic theory to bear on the practice of business lawyering. Is there a deeper understanding of why business lawyers do what they do and a conceptual framework that allows us to better understand the ways in which their activities create value? If the past is a guide for the future, scholars will continue to find points that require further elucidation, additional ways to criticize and broaden underlying theory, and continue to expand the description of transactional lawyering practice and value.

Measurement continues to be a challenge, however; lawyers and clients have difficulty knowing when or how much incremental value lawyers are adding. From my own transactional practice experience, I’m particularly interested in how contractual terms are actually priced or valued as the deal price doesn’t continuously change as lawyers negotiate a contract. We don’t have a

³⁶ *Id.* at 943.

³⁷ See, e.g., ROBERT H. MNOOKIN ET AL., *BEYOND WINNING: NEGOTIATING TO CREATE VALUE IN DEALS AND DISPUTES* (2000); Ronald J. Gilson & Robert H. Mnookin, *Foreward: Business Lawyers and Value Creation for Clients*, 74 OR. L. REV. 1 (1995); Carrie Menkel-Meadow, *Toward Another View of Legal Negotiation: The Structure of Problem Solving*, 31 UCLA L. REV. 754 (1984).

³⁸ Contributors to this interesting and important literature are too numerous to acknowledge; for a small sample, see for example, Gillian K. Hadfield, *Equipping the Guys in the Garage*, 70 MD. L. REV. 484 (2011); Eric J. Gouvin, *Teaching Business Lawyering in Law Schools: A Candid Assessment of the Challenges and Some Suggestions for Moving Ahead*, 78 UMKC L. REV. 429 (2009); Tina L. Stark, *Thinking Like a Deal Lawyer*, 54 J. LEGAL EDUC. 223 (2004); Carrie Menkel-Meadow, *Aha? Is Creativity Possible in Legal Problem Solving and Teachable in Legal Education?*, 6 HARV. NEGOT. L. REV. 97 (2001); Therese Maynard, *Teaching Professionalism: The Lawyer as a Professional*, 34 GA. L. REV. 895 (2000); Charles R. T. O’Kelley, *Delaware Corporation Law and Transaction Cost Engineering*, 34 GA. L. REV. 929 (2000); Steven H. Hobbs, *Toward a Theory of Law and Entrepreneurship*, 26 CAP. U. L. REV. 241 (1997).

full account of the pricing of contractual terms, but this may simply not be possible.

What is possible, and I think important, would be work that explores the implications of the big picture shifts that have occurred in the past 30 years. First, as others have noted, regulation has substantially increased. The regulatory picture is more complex, particularly with globalization, requiring a huge amount of legal expertise to navigate. Moreover, the regulatory environment is frequently changing—creating additional challenges for the business lawyer, and often opportunity for regulatory arbitrage. Second, we've seen the rise of in-house counsel and a more powerful general counsel role.³⁹ Third, great strides in technology have enabled greater, and more efficient, communication and collaboration. Technology has also made information more easily available; yet this is not always a positive. A deluge of information is not useful. Relevant, customized information and services, problem-solving ability, communication and drafting skills, and judgment are valuable.

So what kind of work is being done or might be done to explore the implications of these changes? Part of the conversation could move more specifically to how different types of business lawyers add value—in-house lawyers versus outside counsel, and how they can effectively leverage other non-lawyer resources, as well as improve the quality of contract designs. This could be theorizing value creation in a world where business law services are disaggregated between in-house counsel, outside counsel, and others.

Academics and those with entrepreneurial spirit could also help continue to figure out how technology could be further embraced for overall value creation. Could the pie expand if a menu of model contracts became more standardized through open source or crowdfunding dynamics? Some recent work has started to explore contracts as innovations and how contracts govern interfirm relationships where innovation and entrepreneurship occurs.⁴⁰ Would settled

³⁹ See, e.g., E. NORMAN VEASEY & CHRISTINE T. DI GUGLIELMO, *INDISPENSABLE COUNSEL: THE CHIEF LEGAL OFFICER IN THE NEW REALITY* 30 (2012) (examining how the role of general counsel has expanded in corporate affairs with increased regulation and the complexity of the global economy); Steven L. Schwarcz, *To Make or to Buy: In-House Lawyering and Value Creation*, 33 J. CORP. L. 497, 497, 499 (2008) (discussing “the shift from outside to in-house ‘transactional lawyering’” and providing empirical evidence “suggesting that in-house lawyers may now be performing work as high in quality as outside lawyers and that the reputation value of outside lawyers may be significantly diminishing”).

⁴⁰ See, e.g., Kevin E. Davis, *Contracts as Technology*, 88 N.Y.U. L. REV. 83 (2013) (analyzing contractual innovations and their potential sources); Matthew C. Jennejohn, *Collaboration, Innovation, and Contract Design*, 14 STAN. J.L. BUS. & FIN. 83 (2008) (examining how firms use contracts to govern their collaborations and establish a learning process between collaborators); George G. Triantis, *Improving Contract Quality: Modularity, Technology, and Innovation in Contract Design*, 18 STAN. J.L. BUS. & FIN. 177 (2013) (discussing how technological advances have led to standardization and commoditization of contracts and the potential for innovation through peer production of contracts).

Ed. 1] *Value Creation by Business Lawyers: Where Are We and Where Are We Going?* 21

standard versions add efficiency, freeing up lawyers to work on customized innovations, regulatory navigation, and the value-adding ancillary services they can provide? Along these lines, scholars might study who creates contractual innovations in various industries, how contractual innovations are disseminated, and how they become widely used.

One of the many virtues of the *Value Creation* article, in my view, was its combination of practical and theoretical perspectives—it examined practice in a field, tried to make sense of it, and showed how it might be done better. This has influenced the literature that has followed and the questions Professor Gilson posed 30 years ago will continue to have lasting impact.