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Lawyers and Trust in Business Alliances

By George Dent*

Strategic business alliances (including joint ventures, licensing, franchises, dealerships, distributorships, and strategic investments)\(^1\) are proliferating rapidly due to many economic forces, including economic globalization, intensifying competition and the resulting need of businesses to speed up technological innovation and to adjust faster to changing markets. This should be good news for lawyers: business transactions require advice on legal compliance and the drafting and negotiation skills of lawyers, and complex deals like strategic alliances might be expected to consume an abundance of these services.\(^2\)

Unfortunately, many business people doubt that lawyers add value to strategic alliances; they accuse lawyers of impairing the trust and cooperation needed for a successful alliance. Accordingly, executives often admit lawyers to negotiations as late as possible and even then minimize their role. Some alliances eschew contracts altogether and consign lawyers to handling regulatory issues, which may be minor. This treatment could be viewed as desirable: legal services are costs, and efficiency is usually served when costs of economic activity are lowered. To some extent, though, this abasement reflects a failure of lawyers that damages not only their own wallets but also the quality of strategic alliances. Skillful crafting of alliances can earn handsome legal fees while improving their operation and profitability.

Corporate managers and finance scholars recognize this problem and it is discussed in business literature, but it is almost completely ignored by both practitioner-oriented and scholarly law journals. This lacuna is especially troubling because similar problems with lawyers crop up in other areas, like marriage, where trust and cooperation are needed. This Article attempts a first step in filling the gap in the legal literature. Part I describes the distinctive nature of strategic alliances. Part II discusses why strategic alliances pose unique problems for law-

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1. The definition of "strategic alliance" is fuzzy. For example, a "syndicate" in which "admittedly distinct firms agree by contract, or less formally, to coordinate services on a particular project" might be deemed a strategic alliance (especially if it employs a contract and the firms work together repeatedly), or might not. Randall S. Thomas et al., Megafirms, 80 N.C. L. Rev. 115, 123 (2001).

2. Strategic alliances typically entail much risk and, "[i]n general, the more legal risk there is, the more necessary and valuable legal services are." Donald C. Langevoort & Robert K. Rasmussen, Skewing the Results: The Role of Lawyers in Transmitting Legal Rules, 5 S. Cal. Interdisc. L.J. 375, 377 (1997).
yers. Part III considers how lawyers' negotiation tactics can enhance rather than erode trust between the parties in alliances. Part IV suggests how lawyers can draft substantive contract terms that foster trust and cooperation in alliances. Part V explores how law schools and continuing legal education can train lawyers to perform better not only in strategic business alliances but in all situations where trust and cooperation are important.

**Distinctive Features of Strategic Alliances**

**The Growing Importance of Strategic Alliances**

Perhaps strategic alliances have always caused problems for lawyers but no one noticed because alliances were too minor to merit much attention. That disregard must end because of the growing importance of alliances. Heightened competition, stemming partly from economic globalization, compels businesses to adapt and to innovate faster, especially in technology; to expand the geographic scope of their operations; and to cultivate new markets. Firms once obtained needed inputs (i.e., needed goods and services) in two ways: make them within the firm, or buy them in market transactions. Now, both options are often unsatisfactory. It may take too long or cost too much for a firm to develop its own knowledge of unfamiliar national or product markets or of new technology. It is also difficult for large firms to allow skilled professionals the "independence, and entrepreneurship on which a [smaller] firm's special capabilities rest."

Market purchases may also be unsuitable for acquiring these skills from others. First, market transactions are problematic for confidential information, including valuable technology. Second, market sales do not work well when the desired performance of one or both parties is too vague, complex, or vicissitudinous to


4. See generally OLIVER E. WILLIAMSON, MARKETS AND HIERARCHIES (1975) (dividing business activity between firms (which he calls "hierarchies") and markets); see also Ranjay Gulati, Does Familiarity Breed Trust? The Implication of Repeated Ties for Contractual Choice in Alliances, 38 Acad. Mgmt. J. 85, 87 (1993) (citation omitted) ("[i]n a world without transaction costs all activities would be carried out as exchanges between units, and it is due to the failure of markets, or arenas of exchange, to allow for many exchanges without prohibitively high governance costs that organizations come to exist.").

5. See Bob Tedeschi, What's That Noise on the Internet? The Sound of Alliances Being Forged, N.Y. Times, June 7, 2000, at H25 ("[S]topping to develop expertise in any given area is tantamount to suicide.").

6. JOSEPH L. BADARACCO, JR., THE KNOWLEDGE LINK: HOW FIRMS COMPETE THROUGH STRATEGIC ALLIANCES 104 (1991); see also Joanne E. Oxley, Appropriability Hazards and Governance in Strategic Alliances: A Transaction Cost Approach, 13 J.L. Econ. & Org. 387, 390 (1997) (explaining that joint ventures reduce "the intensity of incentives," but not "to the same extent as in a fully integrated structure (since parties to the transaction retain a degree of autonomy)").

7. See Jean-François Hennart, A Transaction Costs Theory of Equity Joint Ventures, 9 Strategic Mgmt. J. 361, 365 (1988) ("If the seller were to provide ... information in order to educate the buyer on the value of know-how for sale, he would, by revealing the information, be transferring the know-how free of charge.") (citation omitted); Steven R. Salbu & Richard A. Brahm, Strategic Considerations in Designing Joint Venture Contracts, 1992 Colum. Bus. L. Rev. 253, 272 (1992) (explaining that technology joint ventures "often involve the use of organizationally embedded knowledge or sophisticated technology that is difficult to exchange efficiently through arms-length market mechanisms").
be spelled out in a contract. Finally, sales work poorly when a major "relation-specific" asset (including human capital) is needed. One who commits such an asset is vulnerable to the buyer's refusal to pay the cost of the asset. To avoid this Scylla-or-Charybdis choice, "hierarchy and market are being replaced with more connected, lateral forms of organization."

**Contractual Gaps in Strategic Alliances**

No contract is complete; "[a]ll contracts have gaps." In some contracts, however—for a single sale of standard goods, for example—the gaps can be small because the parties' duties are not complex. The seller's duty to deliver goods and the buyer's duty to pay for them can be described adequately without great detail. Uncertainty arising from any gaps that remain is mitigated by the gap fillers in article 2 of the Uniform Commercial Code, including resort to industry practice.

Thus, the exchange is automatically governed by an extensive set of default rules unless the parties agree otherwise.

Inside firms the problem of defining duties is handled by hierarchy: the law of business organizations clothes certain parties with authority over other agents of the firm. A corporation, for example, is "managed by or under the direction of a board of directors . . . ." Thus, the duties of corporate agents (including employees) are fixed largely by the principle, "obey the board and officers acting with authority delegated by the board." Relationships among directors, officers, and other corporate agents are further elucidated by case law. As a result, firms can function with just a few brief documents (typically, a charter and by-laws) supplemented by statutes and case law.

Drafting documents for firms and market transactions is facilitated by repeated use of standard terms. Using standard terms lowers drafting costs, which also

8. See **Williamson**, supra note 4, at 20–24, 75.
13. U.C.C. section 2-202 provides that written contract terms "may be explained or supplemented (a) by course of dealing or usage of trade . . . ." U.C.C. § 2-202 (2002).
makes it cost effective to draft terms to cover contingencies that would be too minor or remote to warrant attention in a one-shot deal. 16

The factors that simplify contracts for market transactions and firms are absent in strategic alliances. Defining the parties' duties is complicated because, unlike the market transaction, an alliance comprises not a single act but continuous action over a long time. 17 Also, each side typically wants the other's sustained "best efforts"—a standard that is necessarily vague. 18 No Uniform Commercial Code provides gap fillers for strategic alliances. Alliances usually link firms in different industries or countries—indeed, a common motive for alliances is to combine the strengths of firms from different industries or markets. In such cases, though, the allies cannot rely on industry custom to fill gaps in their contract.

The utility of contracts is further diminished by problems of detecting and proving a breach. A party often cannot determine whether its partner is exerting its best efforts. Even if a party is certain that its partner is not giving its best efforts, it may be unreasonably expensive or impossible to prove the breach to the satisfaction of a court.

Unlike firms, strategic alliances generally eschew hierarchy. To prevent opportunism, partners often share control equally, but they then need devices to resolve deadlocks. These devices must be designed so that neither party is tempted to force a deadlock in order to reap one-sided benefits. If one partner is given day-to-day control, that power is usually restricted by giving the junior partner either a veto in major matters or some other rights that make it costly for the senior partner to ignore the wishes of the junior. 19 It may be desirable to discourage each party from causing a termination that leaves the other with large sunk costs. 20 At the same time, termination must be available as an escape from intolerable oppression by the other party.

Unlike market transactions, strategic alliances rarely reach a natural completion, so the allies' contract must define when and how the alliance can be dissolved. On this point alliances resemble firms, but for firms there is a default rule that in dissolution firm assets are auctioned off and any surplus is divided among the owners according to their interests. 21 If one owner, however, wants to buy the

16. "If conduct will be frequent, the additional costs of designing rules—which are borne once—are likely to be exceeded by the savings realized each time the rule is applied." Louis Kaplow, Rules Versus Standards: An Economic Analysis, 42 Duke L.J. 557, 621 (1992).


18. See id. at 132 (asserting the impossibility of precisely defining a desired "level of effort" or "delivery of a specific innovation").

19. See infra text accompanying notes 190-91.

20. See TAMAR FRANKEL, TRUSTING AND NON-TRUSTING: LAW COMPARING BENEFITS, COST AND RISK 8 (Boston University School of Law Working Paper Series, Working Paper No. 99-12, 1999) ("When the relationship can be terminated without serious adverse effects, interdependence and verification will be weak, and the parties are more likely to renege on their promises as more attractive opportunities come along."). available at http://www.bu.edu/law/faculty/papers.

21. UNIF. P'SHIF ACT § 38(1) (1914), 6 U.L.A. 487 (2001) (providing that on dissolution any partner who has not wrongfully dissolved may demand that the surplus (if any) be distributed "in cash"). "In effect, this gives each partner the right to force a sale of the partnership assets . . . ."

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firm's assets and cash out the others, disputes about fairness often arise. In strategic alliances an auction of assets or their division in kind is rarely feasible; a buyout by one party is often the only workable solution. Complicated provisions for fair disposition of the assets and division of any surplus are needed.

Little statutory or case law supplies default rules for strategic alliances. True joint ventures are generally treated as partnerships subject to the Uniform Partnership Act, but many of its provisions are ill suited to joint ventures. Many so-called joint ventures are incorporated and thus subject to corporation law. Joint venture corporations, however, are neither public companies nor typical close corporations with individual shareholders who are concerned about their employment in the corporation and their treatment on death, disability, or retirement. And neither partnership nor corporation law applies at all to dealerships, distributorships, licensing, or franchises.

Some strategic alliances are repeat transactions for at least one party. For example, some firms have many franchises. It makes sense for these firms to draft a detailed standard-form franchise contract because the drafting costs are stretched over many transactions. This, however, is an exception. Many alliances are distinctive and require specially drafted terms.

In sum, alliances are complex relationships with few statutes, cases, or standard-form models to govern them. Because their contracts have major gaps, allies must rely heavily on trust.

THE IMPORTANCE OF TRUST IN STRATEGIC ALLIANCES

Some trust between the parties is necessary for virtually any contract: no one deals with a person who threatens to cheat on and breach a contract whenever it


23. "Termination clauses were treated as very important by lawyers. In a typical agreement document, approximately 80 percent of the joint-venture agreement's content was devoted to questions of who would buy out whom, at what price, and who would act as a source to whom after the venture terminated." KATHRYN RUDIE HARRIGAN, STRATEGIES FOR JOINT VENTURES 365 (1985).

24. In both the Uniform Partnership Act section 6(1) and Revised Uniform Partnership Act section 101(6) "partnership" is defined as "an association of two or more persons to carry on as co-owners a business for profit." UNIF. P'SHIP ACT § 6(1) (1914), 6 U.L.A. 393 (2001); UNIF. P'SHIP ACT § 101(6) (1997), 6 U.L.A. 61 (2001). "[T]he joint venture, if distinguished from a partnership at all, must be categorized as a business association similar to the partnership but more narrow in purpose and scope." HAROLD GILL REUSCHELIN & WILLIAM A. GREGORY, THE LAW OF AGENCY AND PARTNERSHIP 451 (2d ed. 1990).

25. Examples are the rules that any partner may dissolve at any time and, unless otherwise agreed, require an auction of partnership assets. UNIF. P'SHIP ACT §§ 31(1)(b), 31(2) (1914), 6 U.L.A. 370 (2001)); see also supra note 21 and accompanying text.

26. See 1 RICHARD D. HARROCH, PARTNERSHIPS & JOINT VENTURE AGREEMENTS § 2.09(2), 275 (discussing "joint venture corporations").

27. Strategic investments in corporations are also ill suited to the usual rules for shareholders. Strategic investments somewhat resemble venture capital investments, but these, too, require complex contracts. (For sample documents, see 1 MICHAEL J. HALLORAN ET AL., VENTURE CAPITAL AND PUBLIC OFFERING NEGOTIATION (3d ed. 2000).) Moreover, unlike venture capitalists, most strategic investors are interested in the investee as a supplier and not just as a financial investment, so model venture capital contracts are also unsuitable for them.
The degree of trust needed in contracts varies widely, though. Where performances can be stipulated without substantial gaps and legal enforcement of the contract will largely compensate the victim of any breach, trust is not very important. This is true of many consumer transactions, for example, in which buyer and seller know almost nothing about each other.

These conditions do not prevail for most strategic alliances. If a party pledges its best efforts to develop new technology in a venture requiring large sunk costs, for example, the partner may be unable to prove a breach of that promise and to obtain a complete remedy for its injury. Accordingly, parties will not contract at all unless they already have some mutual trust.

Moreover, because their duties are often amorphous, each party will constantly monitor the other. If one party thinks the other has violated their trust, the former can often slacken in its own performance without risking a lawsuit because of the problems of legal enforcement, or the offended party may simply terminate the alliance. Thus there must be trust not only at the birth of an alliance but throughout its life. Reliance on trust is not irrational, though it may seem so to lawyers accustomed to getting everything in writing. In our personal lives we trust people we know or who are part of a network to which we belong. Strategic alliances follow this principle. Lacking such a connection, a firm may base trust on its partner's reputation and evident concern to maintain that reputation.

Although a contract cannot create initial trust, the process of negotiating a contract can either enhance or erode trust. Also, contract terms can nurture conditions to maintain and expand trust. Lawyers can be key figures in both of these respects. Moreover, "investors react more favorably to the announcements of joint-ventures between parents in dissimilar businesses." Because trust is likely to be lower in such cases, contracts are more important there, so lawyers' skills can be most important in these potentially most valuable alliances.

**THE DEFINITION OF TRUST**

A definition of trust may seem superfluous; everyone knows what trust is. Commentators disagree, however, about its definition, so some discussion is in order.

To some, trust excludes all calculation; it is what is commonly called blind trust. Oliver Williamson says: "Calculative trust is a contradiction in terms." 28


29. See Ranjay Gulati, *Alliances and Networks*, 19 STRATEGIC MGMT. J. 293, 294 (1998) (explaining that when initiating new alliances, firms "turned to their existing relationships first for potential partners or sought referrals from them on potential partners"); see also id. at 296 (providing that members of a network are likely to have congruent attitudes, "a shared understanding of the utility of certain behavior").


Only a fool, however, makes a contract based solely on blind trust.\textsuperscript{33} Williamson would therefore banish the concept of trust from economic analysis and talk instead of risk and devices that mitigate risk enough to allow reasonable people to contract. Williamson's terminology is logical, but it conflicts with common usage. Trust is usually defined as comprising several levels of risk-taking, and the lowest is often called calculative trust. It relies on legal sanctions for breach; it assumes only that the other party is rational and, therefore, will perform in order to avoid these sanctions.\textsuperscript{34}

Because of the difficulty of specifying duties and proving breaches and the potential for great injury from breach, strategic alliances cannot depend on legal sanctions; greater trust is needed. The kind of alliance that is feasible depends on the depth of the parties' trust. Some alliances can function with an intermediate, or "semi-strong," level of trust which relies on extra-legal economic sanctions, like the loss of future business with the victim or the loss of future business with third parties because of damage to the breacher's reputation.\textsuperscript{35}

In some cases, though, the potential gains from opportunism (and the injury to the victim) exceed the total legal and extra-legal economic sanctions for breach. This is so, for example, when a party does not rely on its reputation or a breach is so difficult to prove and publicize that it would not damage the breacher's reputation. In such cases a deeper trust based on shared values and mutual concern is needed to forge an alliance.\textsuperscript{36} Even this "norm-based trust"\textsuperscript{37} is not blind trust devoid of calculation—the only true trust to Williamson. Norm-based trust typically stems from scrutiny of the partner in past dealings with one's self and inquiry about its dealings with others as well as the parties' concerns about legal sanctions and their reputations and their hopes for future dealings with each other. Semi-strong and norm-based trust so differ from reliance on legal sanctions alone that it seems apt to give them a different name and to choose "trust" as that name.

Even a high level of trust does not assure maximum cooperation. Few firms will accept large losses just to maintain a partner's trust. This is one reason why most alliances eventually terminate. The costs and benefits of opportunism, how-

\textsuperscript{33} See Gulati, supra note 29 and accompanying text.

\textsuperscript{34} Sheppard & Tuchinsky, supra note 11, at 144 (saying that "[i]n the market, the traditional form of deterrence is the courts"). In addition, though, legal sanctions can include private arrangements, like a bond that is forfeited in the event of breach.


\textsuperscript{36} See id. (referring to "a set of internalized norms and principles that guide the behavior of exchange partners").

\textsuperscript{37} See Christel Lane, Introduction: Theories and Issues in the Study of Trust, in Trust Within and Between Organizations: Conceptual Issues and Empirical Applications, supra note 35, at 1, 8–10 (referring to "value-" or "norm-based trust"); see also Sako, supra note 35, at 91 (referring to "strong-form" trust); Mari Sako & Susan Helper, Determinants of Trust in Supplier Relations: Evidence from the Automotive Industry in Japan and the United States, 34 J. Econ. Behav. & Org. 387, 390 (1998) (referring to "goodwill trust"); Sheppard & Tuchinsky, supra note 11, at 145 (referring to "identification-based trust" which "assumes that one party has fully internalized the other's preferences").
ever, are often unclear, and in such cases trust can induce cooperation and compliance where the parties might otherwise choose to defect.

Though a low level of trust may suffice to create an alliance, higher trust may still enhance its value. Often partners begin small, commensurate with a low level of trust. As trust grows they take greater risk by expanding the venture and dropping costly or restrictive measures (like closely monitoring each other) that now seem unnecessary: "Successful alliances . . . evolve through a sequence of learning-reevaluation-readjustment cycles . . . ." 38 This is true of economic transactions in general.39 The challenge for allies, then, is first to establish enough trust to begin an alliance and then to develop that trust so that the alliance can grow to maximum profitability. The challenge for lawyers is to facilitate this process.

THE PROBLEM OF LAWYERS IN STRATEGIC ALLIANCES

OUR CURRENT IGNORANCE

Any discussion of lawyers in business transactions suffers from a dearth of knowledge. Robert Gordon says we lack "thorough, systematic descriptions and reflective analyses of what it is that corporate lawyers actually do."40 The few studies of negotiation of deals examine contract terms, not "negotiation as a means of establishing and growing long-term relationships."41 The imbalance is significant because of the unique qualities of negotiating in a relationship.42 This Article tackles our ignorance by adding to the little existing scholarship lessons drawn from other fields and information from lawyers and business people active in alliances. Our knowledge remains rudimentary, though, so the analysis here is tentative and will require revision as understanding grows.

38. Yves L. Doz, The Evolution of Cooperation in Strategic Alliances: Initial Conditions or Learning Processes?, 17 STRATEGIC MGMT. J. 55, 64 (1996); see also Susan Helper et al., Pragmatic Collaborations: Advancing Knowledge While Controlling Opportunity, 9 INDUS. & CORP. CHANGE 443, 475 (2000) (many alliances start small, then expand); Walter W. Powell, Trust-Based Forms of Governance, in TRUST IN ORGANIZATIONS: FRONTIERS OF THEORY AND RESEARCH, supra note 11, at 51, 60 ("The process is iterative—the level of cooperation increases with each agreement between the same partners . . . .").

39. See Rachel E. Kranton, The Formation of Cooperative Relationships, 12 J.L. ECON. & ORG. 214, 227 (1996) ("[I]ndividuals begin cooperative exchange relationships at low levels of exchange. As partners fulfill their exchange obligations, cooperation rises to higher levels."). It is also true of strategic alliances in particular. "[M]any joint ventures occur as options to expand in the future and are interim mechanisms . . . ." Gulati, supra note 29, at 299; see also Edward H. Lorenz, Neither Friends Nor Strangers: Informal Networks of Subcontracting in French Industry, in TRUST: MAKING AND BREAKING COOPERATIVE RELATIONS 194, 207 (Diego Gambetta ed., 1988) (explaining that customers in French mechanical engineering industry gave new suppliers short contracts; once satisfied with performance, customers gave longer contracts).

40. Robert W. Gordon, Lawyers, Scholars, and the "Middle Ground," 91 MICH. L. REV. 2075, 2088 (1993); see also Karl S. Okamoto, Reputation and the Value of Lawyers, 74 OR. L. REV. 15, 17 n.8 (1995) ("Looking at what corporate lawyers do is something legal academics have, with few exceptions, failed to do.").

41. Sheppard & Tuchinsky, supra note 11, at 154.
42. Id. at 161.
THE BEHAVIOR OF LAWYERS IN NEGOTIATIONS

Client complaints about lawyers are as old as the legal profession itself, and business clients have long swelled the critique. They accuse lawyers of inflating their bills by harping on trifles and of failing to understand the client's business needs or to explain what they do or why they do it. In the context of strategic alliances further criticisms are leveled. Business people complain that many proposed ventures fall through because lawyers are too cautious and adversarial: "[M]any businesspeople are more at ease without lawyers in the room, more confident about getting things accomplished while preserving the goodwill between the parties. They rail at the negative attitudes lawyers exhibit, seeing a problem behind every bush, overcompensating to avoid risk, generating conflict."

LAW VERSUS TRUST?

The preceding discussion suggests that in negotiating alliances all problems with the role of lawyers stem from their improper attitudes. The source of trouble, however, may be more fundamental: the role of law itself in strategic alliances is problematic. Lawyers assume that carefully drafted contracts enhance commercial transactions. The ideal contract covers all issues down to the point where the importance of a contingency and the odds of its occurrence are so low that the costs of drafting, negotiating, monitoring, and enforcing a clause to handle that contingency exceed the value the clause would add to the transaction. Where trust is crucial, however, the existence of a detailed contract and the process of its negotiation may both be detrimental. This principle is most valid in intimate relationships, like marriage. It would be technically difficult to draft

43. See generally Kenneth R. Margolis, The COSE Study: A Report on Small Business Client Satisfaction with the Delivery of Legal Services (1993) (unpublished manuscript, on file with the author); Debra H. Snider, Enough Is Just Enough, CORP. COUNSEL, Oct. 17, 2001, at 57 (describing beliefs of business people that lawyers are guilty of "overlawyering" and should pay more attention to cost efficiency and the client's "business objectives").
44. David Ernst & Stephen I. Glover, Strategic Alliances: Combining Legal and Business Practices To Create Successful Strategic Alliances, INSIGHTS, Oct. 1997, at 6 (providing that when negotiating strategic alliances the instincts of lawyers to minimize risk clashed with the instincts of business people to take risk); see also Sarah Reed, Doing Documents vs. Doing Deals: A Lawyer Confronts a Venture Capitalist, BUS. LAW TODAY, Sept./Oct. 2001, at 13, 14 ("[T]he lawyer and the venture capitalist, by professional predilection, could not be more unlike . . . . [T]he lawyer's job is to minimize the downside, the venture capitalist's job is to maximize the upside.").
45. HARRIGAN, supra note 23, at 363.
46. JAMES C. FREUND, SMART NEGOTIATING: HOW TO MAKE GOOD DEALS IN THE REAL WORLD 186 (1992); see Ernst & Glover, supra note 44, at 6 (stating that lawyers' inclinations may clash with the parties' desire to establish a long-term cooperative relationship).
terms to cover even the bigger issues that all married couples face, and the very effort to do so would intrude a legalism at odds with the love that good marriages require. It is generally better to rely on the spouses' mutual love and care instead of a contract to resolve issues as they arise.

Whether this principle applies to business alliances is debatable: "There is a fundamental disagreement [between those who regard legal contracts] as an alternative mechanism of control which undermines trust [and those for whom] legal regulation of business relations is an important precondition for trust as it makes business relations more predictable and less risky." Some believe that it does:

First, legalistic remedies [e.g., formal contracts] can erode the interpersonal foundations of a relationship . . . because they replace reliance on an individual's "good will" with objective, formal requirements . . . Second, . . . rules and procedures . . . can disrupt . . . "implicit agreements" . . . by imposing a structural barrier between the parties, making the relationship feel less direct and close.

Some firms exclude lawyers altogether and form alliances with no written contract at all. Others, less extreme, stress "the increasing impact and importance of ethics and the declining significance of contract law as one moves toward relational exchange."

Others say a good contract gives partners a security necessary to accept the risks of contributing enthusiastically to the alliance. We can't know how much alliances are hampered by faulty contracts, but we know most alliances fail even though the parties at first expect success. Although Jordan Lewis lists some alliances that omitted a formal contract, he concedes they are exceptions where the parties had already "developed enough comfort . . . In other situations, contracts can be a source of comfort that the fundamentals have been nailed down."

In many alliances partners do not rigorously enforce their contract. Indeed, to enforce contract rights to the letter may connote a lack of trust in one's partner that will undermine the partner's willingness to trust and cooperate. Partners often agree "to make many adjustments, and ignore minor deviations in ways not re-
quired by their contract's written provisions, yet preserves their unfettered right to insist on strict performance of their contract when they think their contracting partner is behaving badly.\textsuperscript{56}

Contracts also have a norm-creating value. Most people feel a moral duty to keep their promises even if they would not have felt obliged to behave the same way in the absence of a promise.\textsuperscript{57} Thus a contract may induce compliance with its terms even if one does not expect that the other party would detect a breach or try to enforce the contract in case of a breach.

Strong judicial enforcement of contracts also promotes success in alliances. It facilitates "new relationships between firms and their customers" and "encourage[s] entrepreneurs to try out new suppliers" and suppliers to extend credit more readily.\textsuperscript{58} To extend the analogy to marriage, the law imposes a mandatory contract that assures each spouse of physical and material security both within the marriage and in the event of its termination. Withdrawing this assurance would deter prudent people either from marrying at all or from making the kind of commitments that help a marriage to succeed.\textsuperscript{59} In business, legal backing can offer "preventive regulation" and punish violators so as to supply the "verification and proof of trustworthiness" often needed to make a deal possible.\textsuperscript{60}

Between the two extremes, some think that legalistic devices produce some desirable and some undesirable consequences.\textsuperscript{61} In this view the ideal level of detail in an alliance contract would depend on both the degree of trust between the allies and the goals and proposed mode of operation of their enterprise.\textsuperscript{62}

\section*{The Awkward Role of Lawyers}

Because they doubt the value of both lawyers and contracts in strategic alliances, some business people bring in their lawyers late in the game.\textsuperscript{63} One

\textsuperscript{56} Bernstein, supra note 30, at 1781; see Lane, supra note 37, at 13 ("[A]ctual use of legal sanctions . . . is incompatible with a trust relationship. Thus law and other social institutions are viewed as mechanisms to coordinate expectations which make the risk of trust more bearable.").

\textsuperscript{57} Thus the sense of duty to comply with one's contracts is but one example of the sense of duty to obey the law. See Tamar Frankel & Wendy J. Gordon, Introduction, 81 B.U. L. Rev. 321, 323 (2001) (discussing the norm-creating function of law).


\textsuperscript{59} See MARY ANN GLENDON, THE TRANSFORMATION OF FAMILY LAW: STATE, LAW, AND FAMILY IN THE UNITED STATES AND WESTERN EUROPE 112 (1989) ("[A]s divorce increasingly came to be considered a right . . . the situation of a married woman without income or resources of her own became precarious indeed.").

\textsuperscript{60} Tamar Frankel, Trusting and Non-Trusting on the Internet, 81 B.U. L. Rev. 457, 474 (2001); see also Stephen Knack & Paul J. Zak, Building Trust: Public Policy, Interpersonal Trust, and Economic Development (forthcoming) (manuscript at 3) (listing "formal institutions that enforce contracts" as one of five elements that build trust), available at http://www.goldmark.org/livia/misc/zak-trust.pdf.

\textsuperscript{61} See Sitkin & Roth, supra note 50, at 367 (claiming that legalistic remedies enhance task-specific-reliability trust but not value-congruence trust).

\textsuperscript{62} See id. at 370-73 (arguing that the desirability of legalistic remedies depends on the circumstances).

\textsuperscript{63} See FREUND, supra note 46, at 186 ("[M]any businesspeople avoid introducing lawyers into the early stages of a deal when, in their view, what's needed is nurturing—not disaster scenarios.").
executive says that when negotiating deals with firms his company has dealt with before "we don't bother to write detailed contracts. That would not only be tedious but also an insult to our relationship. Sometimes we give our lawyers only a few days to write up the contract, and that too after the project may already have begun."64

That attitude is not surprising. To develop trust, partners must get to know each other.65 A lawyer then is as distracting and unwelcome as a third party on a honeymoon. Given lawyers' reputation among business people, their presence may "suggest . . . a reluctance to trust" on the part of the client.66 Many partners already have some knowledge and trust of each other.67 Such cases may resemble a happy marriage more than an ordinary commercial relationship so that hard bargaining is inadvisable; trust is more easily destroyed than created.68

Delaying the participation of lawyers in negotiations may backfire, though:

The most frequent answer explaining why announced joint ventures never went beyond the discussion stage was that ventures were sunk by lawyers. This explanation suggests that managers were homogeneous in their outlooks; lawyers were too adversarial. A more likely explanation for joint-venture deaths at the contract-writing stage was that partners did not think through their arrangements adequately before they reached the altar. The probing questions the lawyers asked exposed these shortfalls in partners' agreements, and the venture fell apart.69

Macaulay quotes one lawyer: "businessmen when bargaining often talk only in pleasant generalities, think they have a contract, but fail to reach agreement on any of the hard, unpleasant questions until forced to do so by a lawyer."70 This oversight may stem not from neglect but from a "reluctance to cross swords di-

64. Gulati, supra note 4, at 95 (quoting a senior manager for a computer software firm); see also David Ernst & Steven Glover, Tug of War: Combining Legal and Business Best Practice, ALLIANCE ANALYST, July 15, 1997, at 39 ("[M]any executives believe best practice is keeping the legal team away from the negotiation for as long as possible.").

65. See Gulati, supra note 4, at 86; see also Jorg Sydow, Understanding the Constitution of Interorganizational Trust, in TRUST WITHIN AND BETWEEN ORGANIZATIONS: CONCEPTUAL ISSUES AND EMPIRICAL APPLICATIONS, supra note 35, at 46 (stressing importance of personal contact between the parties).


67. See Gulati, supra note 29, at 294.

68. See Blair & Stout, supra note 66, at 1776. Not all business firms eschew hard bargaining in strategic alliances, though. Some firms seem to reward each manager based on "the toughness of the deals that he negotiates." Lerner & Merges, supra note 17, at 153. In the biotechnology industry many alliances are heavily negotiated. Id. at 135. Indeed, in order to extract greater control, firms offering financing sometimes deliberately "protract[ed] negotiations until the R&D firm was in a financial crisis." Id. at 152. It is unclear how common such behavior is and whether it is concentrated in certain industries or types of transactions.

69. HARRIGAN, supra note 23, at 363.

70. Stewart Macaulay, Non-Contractual Relations in Business: A Preliminary Study, 28 AM. SOC. REV. 55, 59 (1963); see also FREUND, supra note 46, at 186 (saying that the critique of lawyers is in some ways "a bum rap. Businesspeople . . . often pass over a number of the potential issues lurking in most transactions. The lawyer comes in and poses some logical questions."); LEWIS, supra note 51, at 262 (explaining that lawyers may be blamed for disagreements because they "raise issues management did not address").
rectly with a counterpart who will be working closely with the principal once the relationship is established." Lawyers who will not be part of that ongoing relationship can discuss issues that may be too sensitive for the business people. Some terms that lawyers value but that business people deprecate "are in fact underpinned by important business considerations." 72

Similarly, lawyers can help clients be objective and pragmatic. People often exaggerate their own merits. A client may overrate its own contribution and, therefore, underestimate the concessions needed to reach agreement. 73 In market transactions comparison with similar deals imposes a reality check on inflated expectations. Most alliances are distinctive deals that lack such bases for comparison, so a gimlet-eyed outsider can be useful, especially for a party with little experience in alliances. 74

A lawyer can also protect a client from the excessive trust when partners "over-identify." 75 A lawyer need not counsel clients to be suspicious or skeptical but can simply point out that most alliances eventually deteriorate, 76 and then the once friendly parties often start to play rough. 77 The lawyer can prescribe contract terms to avoid the causes and bad consequences of failure. The client may choose to assume a risk rather than seek a provision to avoid it, but at least then the client has pondered the problem rather than having naively overlooked it.

The importance of independence and objectivity also suggests how outside counsel may be superior to house counsel in negotiating strategic alliances. Because outside counsel is outside, its broaching and negotiation of unpleasant issues may not be imputed to the client by the other party as it would be if done by house counsel. By negotiating alliances for several clients, outside counsel can acquire broader experience than in-house lawyers. This experience may give outside counsel both better judgment and greater credibility with business people than house counsel has. As a full-time employee of the client, house counsel may flinch, either deliberately or unwittingly, from giving advice the business people don't want to hear. Outside counsel may be bolder.

71. FREUND, supra note 46, at 176; see also HARRIGAN, supra note 23, at 363 (saying that many business "managers found the act of writing contracts unpleasant"). The parties could choose as negotiators business people who will not later be involved with the alliance, but that would be unwise: "There is only one way to develop an alliance if you expect superior performance: Have the implementers be the negotiators. It is always a mistake to assign these phases to different people." LEWIS, supra note 51, at 27.

72. Reed, supra note 44, at 14.


74. See FREUND, supra note 46, at 176 (stating that bargaining through an agent may be beneficial in part because of "the principal's emotional involvement in a high-stakes deal, which hampers his ability to negotiate effectively").

75. Roderick M. Kramer et al., Collective Trust and Collective Action: The Decision to Trust as a Social Decision, in TRUST IN ORGANIZATIONS: FRONTIERS OF THEORY AND RESEARCH, supra note 11, at 357, 380. In such cases one can be too lenient and fail to question one's partners even when they are wrong. See id. at 380-82.

76. See supra note 54 and accompanying text.

77. See Blair H. Sheppard, Negotiating in Long-Term Mutually Interdependent Relationships Among Relative Equals, in 5 RESEARCH ON NEGOTIATIONS IN ORGANIZATIONS 35-36 (Robert J. Bies et al. eds., 1995) (listing some aggressive practices pursued in some relational contract situations).
Even if the executives negotiating a deal plan to take part in its implementation, they usually expect to be involved for a limited time. Accordingly, they may disregard issues unlikely to arise at the start of the alliance. Like a Ponzi scheme, though, an alliance may project an illusion of success that explodes only after some time. During negotiations, then, lawyers may have to persuade reluctant business people to focus on these issues.

Further, it is not only typical but fitting that business people should be more optimistic than their lawyers about deals. All deals pose risks that will be taken only by those who predict success, so business people tend to be sanguine about their deals. Pride of authorship bolsters their optimism. Lawyers tend to identify with their clients, but the lawyers’ greater distance from the deal tempers their vicarious optimism. Further, the role of lawyers, as emphasized in their training, is to induce caution by spotting problems. Some tension between lawyers and their business clients, then, is natural and desirable and not just a result of bad lawyering.

The critique of business lawyers may be exaggerated but it poses a public relations problem. Clearly business lawyers must do better in explaining their work and their bills to clients. The problem is not just one of perceptions, though; the critique has a lot of truth. Overlawyering, excessive pugnacity of lawyers, and their failure to understand clients’ business objectives are especially problematic in strategic alliances. Even before entering law school, future lawyers are imbued with our culture’s image of lawyers as aggressive advocates for their clients. The media usually show lawyers as litigators engaged in legal combat. They are often portrayed as unscrupulous. Even the heroic lawyer is a gladiator sent forth to vanquish the opposing party.

Lawyers are taught to be careful and thorough, to dot all i’s and cross all t’s. Hourly billing gives lawyers an incentive to find more issues requiring negotiation and drafting. Cognitive biases reinforce this tendency: “People (like lawyers) who are paid to worry will find something to worry about.” Lawyers also fear that if they make a concession by omitting a term and trouble later arises because of the omission, the client will blame the lawyer. Clients may consider this conduct expensive nitpicking, but it generally won’t bother the other party. In negotiating an alliance, however, a lawyer’s endless carping may erode the trust and cooperation the parties want to cultivate.

Legal education exacerbates these problems. Most law school courses employ the case method which uses actual or hypothetical lawsuits. All students simulate litigation in moot court. Even courses on transactions or alternative dispute resolution hardly alter the model of the lawyer as hatchet man. In these contexts

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78. See Langevoort & Rasmussen, supra note 2, at 389–93 (showing how hourly billing encourages overlawyering).
79. Id. at 425.
lawyers are told to be less adversarial and pursue agreement with the other party. One may seek agreement, however, not by winning the other’s friendship but by aggressive tactics like intimidation.\textsuperscript{81} In general, law students “are trained to question, doubt, to be adversarial, to be independent, to be competitive, and to think win-lose. At or near their extremes, each and all of these concepts can and often do work at cross purposes to earning, building, and maintaining trusting relationships.”\textsuperscript{82}

The bar encourages lawyers to act like hired guns by making them responsible almost solely to the client, who is to be represented “with zeal.”\textsuperscript{83} The lawyer may not even reveal a client’s criminal conduct except in case of imminent bodily harm.\textsuperscript{84} Like a hardened soldier returning to civilian life from a savage war, the lawyer steeped in the doctrine that “winning isn’t everything; it’s the only thing” cannot easily adjust to a situation like a strategic alliance where success in negotiation demands fostering trust and cooperation with another party.

Ironically, business people who exclude lawyers until late in negotiations because they dislike lawyers’ pugnacity may exacerbate that pugnacity. Latecomer lawyers lack the personal trust and friendship the business people have already cultivated. Accustomed to a bigger role in deals, lawyers arriving at the last minute may feel slighted and threatened and try to re-assert their importance by being even more aggressive than usual.

Excluding the lawyers until the last minute may also result in a bad deal for one or both sides. Squeezed for time and stuck with terms already settled by the business people, the lawyers may not be able to craft suitable terms. A bad contract may not injure both sides equally. A firm that has little experience with alliances may accept terms with problems it is not aware of.\textsuperscript{85} If their late-arriving lawyers enlighten them, they may still feel foreclosed from renegotiating those terms, even if additional terms could increase the value of the alliance.\textsuperscript{86}

**THE ROLE OF LAW IN DEFINING THE RANGE OF ALLIANCES**

Strategic alliances have multiplied primarily because of changing market conditions and technology, but these factors do not completely determine the proper realms of hierarchy (i.e., the firm), alliance, and market transaction—law and lawyers are also relevant. If, for example, courts do not impose as default rules

\textsuperscript{81} See generally Robert J. Ringer, Winning Through Intimidation (1974).


\textsuperscript{83} See Model Rules of Prof’l Conduct R. 1.3. cmt. 1 (2002) (“A lawyer must also act . . . with zeal in advocacy upon the client’s behalf.”).

\textsuperscript{84} See id. R. 1.6(b)(1).

\textsuperscript{85} See Rasmussen, supra note 47, at 43 ("The purpose of the legal staff is to deter the other side from trying to be sly or dishonest . . . .").

\textsuperscript{86} See Freund, supra note 46, at 186 (explaining that businesspeople who have "shaken hands on a deal, and who then try to introduce new terms and conditions suggested by their lawyers, may find themselves accused of renegotiating the deal"); Bernstein, supra note 80, at 195 (stating that the price in deals is usually set before the lawyers arrive "and does not usually change continuously as the lawyers negotiate other contractual provisions").
the fiduciary duties that maximize the value of alliances, partners must do costly drafting to re-define their fiduciary duties, endure a sub optimal alliance, or eschew an alliance altogether in favor of a firm or market transaction. 87

Similarly, the greater the lawyers’ skills, the more parties can rely on contracts to achieve their goals. 88 This does not necessarily mean that improved lawyering will advance alliances and market transactions at the expense of internal firm expansion because astute legal planning can improve incentives and diminish agency costs in firms as well. Because contract negotiations can expand or reduce the trust that is so important to alliances, the relevant lawyers’ skills include negotiating as well as drafting.

**THE LAWYER’S ROLE IN NEGOTIATIONS**

**ATTENTION TO THE CLIENT’S BUSINESS NEEDS**

To improve their transactional practices lawyers must first change their attitudes toward their clients. “[E]lite law practitioners do not adequately and efficiently determine the client’s objectives for the representation.” 89 The problem is especially acute with strategic alliances because, unlike most business deals, the transaction does not end but only begins with the closing and can last for years. Also, goals are often vaguer in alliances than in other deals; the aim may be no more specific than the optimal exploitation of each side’s research capabilities. Again, to attain such a goal trust and cooperation are vital. Lawyers accustomed to concrete objectives may not effectively pursue or even understand so amorphous an enterprise.

There are several reasons for this failure. First, lawyers tend to assume that the client wants them to bargain aggressively for the maximum feasible share of the benefits of a deal. This assumption is valid in most situations, including not only litigation but many business deals, but it is often unwarranted in strategic alliances. 90 Second, the bar has a tradition of independence that may seem inconsistent with seeking detailed instructions from the client. Of course, lawyers need some independence in order to meet ethical mandates, but this duty does not bar lawyers from asking about the client’s objectives.

Third, like a lost driver who refuses to ask directions, many lawyers fear that seeking instructions makes them look ignorant. This fear may be justified. A word to the wise is sufficient, but lawyers who are ignorant about business may expose their ignorance by asking the client foolish questions and mishandling the answers they get. Foregoing guidance, though, only makes matters worse. Lawyers should overcome embarrassment about seeking instructions, especially about business

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87. See generally Dent, supra note 3.
88. See Holmstrom & Roberts, supra note 9, at 82 (suggesting that provisions for “rich information sharing” benefit alliances because “potential information asymmetries are reduced”).
90. See supra note 45 and accompanying text.
goals. A good agent always spends time with his principal reviewing the likely bargaining issues in order to understand what’s important to the principal. One lawyer’s first rule for outside counsel is “Know Your Client.” Lawyers’ arrangements with clients are themselves relational contracts; “neither lawyers nor clients can effectively perform without cooperation from each other.”

As the last statement implies, the need to explain runs both ways. Sophisticated clients may know when to ask a lawyer to explain a legal principle or contract term, but clients from some cultures hesitate to ask such questions. Clients who are new to strategic alliances may not even know what they don’t know.

To improve communication with clients the training of business lawyers must change. Unfortunately, growing pressure to keep fees down forces law firms to reduce, not expand, apprentice training of new lawyers. Law schools, however, can do a better job. Most corporate law casebooks pay little attention to business goals, which they may erroneously assume are always obvious. The instructor can raise these issues, but casual inquiries suggest that most rarely do so. Apart from improving instruction in individual business courses, law schools can also offer better overall programs in business law. Some schools now have concentrations in various fields, including business organizations. A well designed program can make lawyers more sensitive to clients’ business needs.

The proliferation of house counsel in recent years is evidence both of the shortcomings of outside counsel and of the possibility of ameliorating those shortcomings. As full-time employees of their client, in-house lawyers are naturally attuned to the business needs of the client and in constant contact with its business people to keep abreast of those needs. They have little reason to fear that they will look foolish by discussing and asking questions about these needs.

Despite the advantages in-house lawyers enjoy, their role tends to be limited to “routine legal work”; corporations “remain dependent on outside counsel for specialized advice and representation in critical high-risk areas,” like areas where the law is changing. The very factors that cause firms to undertake projects through alliances rather than through integration—factors like a need for flexi-

92. FREUND, supra note 46, at 178.
93. Marjorie Doyle, Corporate Clients: A Recipe for Successfully Keeping and Working With Them, 10 CORP. COUNSEL Q. 64, 64 (1994). Her other rules are largely corollaries of the first; e.g., “Keep Good Communication.” Id. at 66.
94. Painter, supra note 91, at 517; see also Amy L. Stickel, The Odd Couple: GCs and Law Firms Struggle to Find Common Ground, CORP. LEG. TIMES, July 2002, at 1, 62 (“General counsel need to communicate to law firms what the business goals are . . . .”).
95. See Thomas Adcock, Avoiding Culture Clashes, N.Y. L.J., Feb. 26, 2002, at 16 (“Clients from some cultures . . . will feel reluctant to ask for clarification for fear of offending the lawyer or embarrassing himself” (quoting Bryant, infra note 236, at 43)).
96. For instance, my own institution, Case Western Reserve University School of Law, has created concentrations in several fields, including Business Organizations.
97. See Rosen, supra note 89, at 488.
bility, rapid adaptation, and effective incentive compensation schemes—also apply to legal services.

Despite their proximity to the client, in-house lawyers are still subject to second-guessing (or "hindsight bias") if their advice, however wise, results in problems. Because in-house lawyers have only one client, they may be even more risk-averse than the more diversified outside counsel. To protect themselves from second-guessing they may not only bargain too aggressively but may also call in outside counsel to assume some of the risk.

Thus, the decision to "make or buy" transactional lawyers often depends on the effectiveness of outside counsel. If outside lawyers do a better job by, inter alia, communicating better with clients and paying closer attention to their business needs, there will be more demand for their services.

NEGOTIATING TO ENHANCE TRUST AND COOPERATION

Negotiating alliances requires tactics quite different from the norm for lawyers. As one expert says, "more problems in alliances are due to weak relationships than to anything else." Aggressive bargaining undermines trust. "Pressing the other firm to retreat, or making implied threats, lowers people's enthusiasm and causes them to withhold information and protect their interests." Further, "[s]ignals of mistrust breed mistrust." "People who distrust the motives of others tend to have more rigid and narrow expectations and to provoke the very reactions they fear." Similarly, "if people receive signals that they are not trusted, they are likely to become less trustworthy."

Good business lawyers realize this. "[T]he image of the lawyer as hired gun is not an accurate characterization of the role of any transactional business lawyer, at least any good transactional business lawyer . . . ." Instead of battling tooth

99. See supra notes 4–10 and accompanying text.


101. LEWIS, supra note 51, at 20.

102. Id. at 43; see also Blair & Stout, supra note 66, at 1776 (stating that aggressive lawyers can quickly demolish trust slowly built up between the parties over a long time); Bernstein, supra note 80, at 229 (stating that hard bargaining increases "attitudinal costs"); Lisa Bernstein, The Silicon Valley Lawyer as Transaction Cost Engineer?, 74 OR. L. REV. 239, 249–50 (1995); David Charny, Nonlegal Sanctions in Commercial Relationships, 104 HARV. L. REV. 375, 405 (1990) (stating that adversarial bargaining can "raise[e] the specter of litigation for transactors who wish to view themselves as friends and partners"); Sheppard, supra note 77, at 25 ("[B]linding, painful discussions can create antagonistic relations.").

103. Frankel, supra note 60, at 459.

104. John G. Holmes & John K. Rempel, Trust in Close Relationships, in CLOSE RELATIONSHIPS 187, 190 (Clyde Hendrick ed., 1989). Conversely, "those who are more willing to trust other people are likely to be equally trustworthy in that they are less likely to lie, cheat, or steal." David Good, Individuals, Interpersonal Relations, and Trust, in TRUST: MAKING AND BREAKING COOPERATIVE RELATIONS, supra note 39, at 32.

105. Frankel & Gordon, supra note 57, at 322.

106. Bernstein, supra note 102, at 241.
and nail for unilateral advantage, the parties should seek “mutual satisfaction.”\(^{107}\) This does not mean just splitting the difference on disputed points; with that approach “creativity suffers. People feel compromised . . . .”\(^{108}\) Rather parties can work to expand the total pie so that both feel like winners.\(^{109}\)

Sometimes a lawyer need not be aggressive to gain a one-sided agreement. If one partner is smaller, poorer, and has no feasible alternative to the alliance under consideration, it may have little choice but to accept whatever terms the stronger side demands. This situation naturally appeals to the stronger party’s lawyer, who not only can get her way without a fight but also speedily close the deal at a cost the client will like.

Nonetheless, the lawyer should ask the client whether to exploit its advantage. An alliance needs trust and cooperation; it will not thrive if even one side judges the deal unfair. People who feel abused often retaliate, even if they know that retaliation is costly.\(^{110}\) In a bad contract both sides may withhold their best efforts. The stronger party should seek fair terms, explain its proposals, and listen to its partner. People more readily accept a result if they helped create it and understand the reasons for it.\(^{111}\) Lawyers should not assume that the other party’s silence reflects agreement but should ask the other if it considers the terms fair.

Not all negotiators so behave. The beneficiary of an unfair term may deride efforts by the other party’s lawyer to address this problem by contract as over-lawyering that is eroding trust. A lawyer needs a close relationship with the client so as to retain its support in the face of such criticism.

While seeking mutual benefit parties need not eschew self-interested bargaining,\(^{112}\) but advantage should be pursued with prudent restraint. Trust evaporates if a party refuses to budge on numerous points, so each side should identify its

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107. FREUND, supra note 46, at 23–24; see also Ronald J. Gilson & Robert H. Mnookin, Foreword: Business Lawyers and Value Creation for Clients, 74 OR. L. REV. 1, 10–11 (1995) (calling the concern of each party to maximize its own profit a pitfall in bargaining).

108. LEWIS, supra note 51, at 45.

109. See Neale & Bazerman, supra note 73, at 40 (calling this approach “integrative bargaining”); FREUND, supra note 46, at 21–22.


111. See Joel Brockner & Phyllis Siegel, Understanding the Interaction Between Procedural and Distributive Justice: The Role of Trust, in TRUST IN ORGANIZATIONS: FRONTIERS OF THEORY AND RESEARCH, supra note 11, at 390, 391; see also id. at 402 (“[P]rocedural justice positively influences trust.”).

112. See FREUND, supra note 46, at 24–25 (cautioning against “cooperative bargaining” stating that “some familiar maneuvers, some give and take” are part of a “process” that is expected and makes most people comfortable).
Proposing a complex contract may itself undermine the other party's trust because it indicates that the proponent does not trust the other party: "Businessmen often prefer to rely on 'a man's word' . . . ."[114] "[P]arties propose simple contracts . . . in order to signal that they are trustworthy."[115] Complex contracts are also more costly to draft[116] and can restrict flexibility in an alliance that will need to adapt to unanticipated conditions over a life of several years.[117]

Simple contracts foreclose attention to detail and drafting to cover as many issues as possible, practices often considered hallmarks of a good lawyer.[118] Lawyers also specialize in spotting and addressing potential problems of opportunism, but this focus can diminish trust and the willingness of parties to make concessions.[119] Business people reject these practices not only because hard bargaining erodes trust but also because they rely on reputation to deter each other from opportunism.[120]

Proposing unusual terms also impairs trust by signaling that the client will "rely on his legal rights" in case of a dispute rather than trying to resolve it amicably.[121] Uncertainty about the meaning and impact of a novel term makes the other party...

113. See Karen Eggleston et al., The Design and Interpretation of Contracts: Why Complexity Matters, 95 NW. U. L. REV. 91, 116 (2000) ("The contract need deal only with states in which the payoffs are very high, for it is in these states that the threat of retaliation [or other extralegal sanctions] may not deter a party from engaging in opportunism."); FREUND, supra note 46, at 69-70, 82.

114. Macaulay, supra note 70, at 58; see also Blair & Stout, supra note 66, at 1806 n.206, 1807 n.209 (stating that a detailed contract may undermine trust).

115. Eggleston et al., supra note 113, at 117; see Samuel Bowles, Endogenous Preferences: The Cultural Consequences of Markets and Other Economic Institutions, 36 J. ECON. LITERATURE 75, 95 (1998) (stating that cooperation is more likely if parties consider their contract incomplete); Gulati, supra note 4, at 95 (saying firms eschew tight contracts if they have "familiarity with their partners and judgment that they were trustworthy"); Macaulay, supra note 70, at 64 (saying that "[s]ome businessmen object that in . . . a carefully worked out relationship one gets performance only to the letter of the contract," whereas performing to the spirit of the contract would offer mutual expected gains); see also supra note 62 and accompanying text.

116. One side pays to draft a detailed contract; the other may pay even more to read and divine its ramifications. See RASMUSEN, supra note 47, at 39.

117. See LEWIS, supra note 51, at 27 ("Because they are intended to make regular advances, alliances depend on ongoing change."); Helper et al., supra note 38, at 466. Detailed contracts may require frequent recourse to the partners' headquarters for interpretations, waivers, or modifications, which can cause damaging delay. A detailed contract may also restrict the ability of one party to retaliate against uncooperative behavior by the other. See generally ERNST FEHR ET AL., FAIRNESS, INCENTIVES AND CONTRACTUAL INCOMPLETENESS (CESifo Working Paper No. 445, 2001).

118. See Snider, supra note 43, at 57 ("Simply put, clients want 'good enough' legal services, and outside lawyers frequently strive to deliver work worthy of an A+ on a law school exam.").

119. See Neale & Bazerman, supra note 73, at 42-44. This phenomenon stems from most people's loss aversion, so that "framing" negotiations to focus on potential gains rather than possible losses facilitates reaching agreement. See id.

120. See supra note 35 and accompanying text.

121. Lisa Bernstein, Social Norms and Default Rules Analysis, 3 S. CAL. INTERDISC. L.J. 59, 70-71 (1993); see also Bernstein, supra note 80, at 230 n.107 (stating that the biggest factor in eroding trust "is whether the proposal departs from custom"). "Merely suggesting an agreement other than the one provided by [the law's default rules] implies anticipation of a breach rather than the total commitment of true love." Id. at 232.
even more suspicious.  

Using standard terms curbs a lawyer's creativity, but it is safer for the lawyer and may benefit clients.

As well as bad practices to avoid, there are good practices to follow. The parties should strive not only for the best contract but also to build mutual trust: "The task at [the] initial stage is not to nail down specifics, but to raise mutual awareness and become more comfortable." Often firms conclude an alliance "only after people have built constructive relationships, usually over several months." Some of the most resolute positions soften when people know each other better.

This is true for lawyers as well as business people. One veteran says "the attorney on the other side and I see each other as partners facilitating a mutually beneficial business arrangement." This is done by "signaling of shared assumptions and understandings at the very beginning. Competence, benevolence, and integrity [are] important antecedents of trustworthiness." Jordan Lewis recommends: "avoid the common mistake of exchanging written proposals." And: "start with views, not positions . . . . Candor is our style; bluffing and deception are unacceptable . . . . We will use only logic, not politics or pressure, to find the best solutions." Negotiating behavior is so important some firms "select people with less than perfect intellects but with excellent interpersonal skills." During negotiations, good lawyers can remind clients that in strategic alliances, contract terms are not always meant to be kept.

Further, with relational contracts, "the context in which [the negotiation] is embedded" demands greater attention. The extent to which partners do or should rely on trust and reputation rather than on contract depends on both the

122. See Bernstein, supra note 80, at 248–50 (stating that using standard terms bolsters trust because the parties are familiar with them and don't need an effort to understand them or to predict their effect). Other benefits of standard terms include "avoidance of formulation errors, ease in drafting, and availability of judicial rulings on the validity and interpretation of the term." Marcel Kahan & Michael Klausner, Path Dependence in Corporate Contracting: Increasing Returns, Herd Behavior and Cognitive Biases, 74 WASH. U. L.Q. 347, 350 (1996).

123. See id. at 354–56 (stating that lawyers prefer standard terms because their results are more predictable and the lawyer's reputation will suffer less if a bad outcome results from a standard term rather than a novel term).

124. One commentary lists the following: Be cordial and flexible; be an active listener; have stamina; know when to say no; do not negotiate against yourself; and stop arguing after you win. Thomas F. Villeneuve & Daniel M. Kaufman, Creating Successful Technology-Based Corporate Partnering Arrangements, in STRUCTURING, NEGOTIATING & IMPLEMENTING STRATEGIC ALLIANCES: 2001, at 59, 72–73 (PLI Corporate Law & Practice Course, Handbook Series No. B-1260, 2001).

125. Lewis, supra note 51, at 22.

126. Id.

127. Id. at 23. People are more inclined to cooperate when they believe that others will cooperate and that cooperation will benefit all participants. See Robyn M. Dawes, Social Dilemmas, 31 ANN. REV. PSYCHOL. 169, 182–88 (1980) (summarizing results of many studies).

128. Lewis, supra note 51, at 262 (quoting an unnamed lawyer).

129. Sydow, supra note 65, at 38.

130. Lewis, supra note 51, at 41.

131. Id. at 220.

132. Id. at 29 (citation omitted).

133. See supra note 56 and accompanying text.

134. Sheppard & Tuchinsky, supra note 11, at 147.
nature of the partners and on their past dealings. A small, new firm, for example, may not have much of a reputation and may be unwilling to incur large costs to develop one. If the parties are strangers to each other and come from different industries, or countries, or both, neither may have much reason to trust the other. Each may fear not only the other's opportunism, but also that there may be sincere disputes about their duties in the alliance. In such cases, a tight contract can reassure them that they agree on what each must do and that promises will be kept.

A focus on context precludes the usual modus operandi of business lawyers—drafting a contract by simply changing the names on the last deal. Tailoring a unique contract (without resorting to unusual terms) takes more of a lawyer's time and, therefore, is more expensive for the client. If lawyer and client communicate closely, though, this should not be a problem. If the transaction does not warrant a detailed contract—either because the money involved is too small or because the parties rely heavily on trust—the client can so inform the lawyer.

**SUBSTANTIVE TERMS IN STRATEGIC ALLIANCES**

The analysis so far has focused on process, and on the behavior of lawyers in negotiating strategic alliances. Most of the discussion has concerned detrimental practices to avoid, but lawyers can also add value with the substantive terms they draft.

**WHETHER TO ENTER AN ALLIANCE**

Whether to "make or buy" an input or to obtain it through an alliance is a business question, but lawyers can help answer it by explaining the legal problems and benefits of each option. For example, inability to monitor, evaluate, and control the partner's performance is often a problem in alliances, but this is also a problem with employees if the firm "makes" the input. Indeed, it may be easier to end an unsatisfactory alliance than to fire unsatisfactory employees. It is also easier to design disincentives to termination for a partner than for an employee because little can be recovered from an employee who quits.

135. See Gulati, supra note 4, at 95 ("[F]irms trust domestic partners more than international partners, not only because more and better information is available about domestic firms, but also because the reputational consequences of opportunistic behavior are greater in a domestic context.").

136. See Sim B. Sitkin & Darryl Stuckel, The Road to Hell: The Dynamics of Distrust in an Era of Quality, in TRUST IN ORGANIZATIONS: FRONTIERS OF THEORY AND RESEARCH, supra note 11, at 196, 198 (stating that legalistic mechanisms (like detailed contracts) are useful in fostering trust where it does not already exist).

137. See supra notes 122–23 and accompanying text.

138. See Oxley, supra note 6, at 389 (discussing the influence on alliance structure of "appropriability hazards," which she defines as comprising problems of drafting, monitoring the partner, and enforcing the contract).

139. Firing employees may, for instance, trigger problems under anti-discrimination and unemployment benefit laws.

140. See CALAMARI & PERILLO, supra note 48, at 570 (describing "a strong policy against" awarding consequential damages against employees).
CHOICE OF ENTITY: INTRODUCTION

Often, a key decision for the lawyers is whether to create a separate entity for the alliance and, if so, what form to give it; alliances choosing the wrong structure are less profitable than those choosing the right structure. The choice depends on both legal issues (like taxes and limited liability) and transaction cost economics.

Many alliances are called "joint ventures," but this term is ambiguous. In law, a true joint venture is basically treated as a general partnership except it usually implies a single, limited enterprise rather than a broad collaboration of indefinite duration. Many so-called "joint ventures" are incorporated, however, in which the entity is legally a corporation and is often called a "joint venture corporation."

The legal status of other alliances may be unclear. "The receipt by a person of a share of the profits of a business is prima facie evidence that he is a partner in the business . . . ." In a franchise, dealership, distributorship, or licensing agreement, each party pursues profit, but these arrangements are not usually partnerships because profits are earned separately, not shared from a single pool. The line, however, marking the boundary of profit-sharing that defines a partnership is hazy.

The legal status of an alliance may be important in several ways. For example, partners are agents of the partnership with authority to bind it when acting in the ordinary course of its business. Partners are also liable for the debts of the partnership. Neither of these rules applies to either the shareholders of corporations or to parties to a sales contract.

141. See Rachelle C. Sampson, The Cost of Inappropriate Governance in R&D Alliances, at i (unpublished manuscript, on file at http://www.law.columbia.edu/law-economicstudies/workshops/Rsampson01.pdf) (finding that "alliance governance selected according to transaction cost arguments improves collaborative benefits substantially over governance not so selected").

142. See generally Oxley, supra note 6.

143. Both the Uniform Partnership Act section 6(1) and Revised Uniform Partnership Act section 101(6) define "partnership" as "an association of two or more persons to carry on as co-owners a business for profit." UNIF. P'SHIP ACT § 6(1) (1914), 6 U.L.A. 393 (2001); UNIF. P'SHIP ACT § 101(6) (1997), 6 U.L.A. 61 (2001). "[T]he joint venture, if distinguished from a partnership at all, must be categorized as a business association similar to the partnership but more narrow in purpose and scope." REUSCHELIN & GREGORY, supra note 24, at 451; see also 1 HARROCH, supra note 26, at 2-73.

144. See 1 id. § 2.09(2), at 2-75.


146. See WILLIAM A. GREGORY, THE LAW OF AGENCY AND PARTNERSHIP §§ 175, 178 (3d ed. 2001) (discussing complexities of profit-sharing as an element of definition of "partnership").

147. UNIF. P'SHIP ACT § 9(1) (1914), 6 U.L.A. 553 (2001); UNIF. P'SHIP ACT § 301(1) (1997), 6 U.L.A. 101 (2001); see also 1 HARROCH, supra note 26, at 2-74 (saying that "each joint venturer has the power and ability to bind the other joint venturer and to subject it to liability to third persons in matters which are within the scope of the enterprise").


149. See GEVURTZ, supra note 22, § 1.1, at 2 (calling limited shareholder liability the "most significant" feature of the corporate form).
The choice of entity also influences the scope of the allies' fiduciary duties. Members of a partnership owe each other high fiduciary duties. The scope of fiduciary duties in a non-public corporation is uncertain. Some states impose the same fiduciary duties for them as for partnerships, at least when the shareholders are individuals; others do not.

Fiduciary duties may determine, for example, whether one party to an alliance must share a business opportunity with the other or can dissolve the alliance and force a sale of its assets. To some extent, fiduciary duties may be modified by agreement, but modifications require costly drafting and the permissible scope of modifications is not unlimited. If both parties to an alliance want it limited in scope, have other alliances, and are wealthy enough not to fear an opportunistic dissolution by the other, they may prefer to owe each other low fiduciary duties. Often, however, these conditions do not hold for at least one party, which may prefer high fiduciary duties.

A clear statement of the scope of the alliance can define what opportunities parties may take only through the alliance and which they may pursue alone or with third parties. But specific terms can never cover all contingencies and fiduciary duties are invoked to answer questions not resolved by the contract. One party may come to feel that these fiduciary duties are so broad that its freedom to act outside the alliance is unduly restricted, or so narrow that it is not being treated fairly by its partner. The disgruntled partner then may either shirk in its performance or seek to terminate the alliance. Thus, lawyers need to set the right level of fiduciary duties, and choice of the form of entity is an important step in so doing.

Alliances can be classified on a continuum at one end of which are 50-50 joint ventures where control and profits are shared equally. In the middle are alliances that have majority and minority partners. Both kinds are called "equity alliances." At the other end is the bilateral sales or service contract, in which duties

150. See GREGORY, supra note 146, § 188, at 298 ("The standard by which fiduciary duty is measured is historically a high standard . . . .").

151. Compare Donahue v. Rodd Electrotype Co. of New Eng., 328 N.E.2d 505, 515 (Mass. 1975) (holding that "stockholders in the close corporation owe one another substantially the same fiduciary duty in the operation of the enterprise that partners owe to one another") (footnotes omitted), with Nixon v. Blackwell, 626 A.2d 1366, 1379-81 (Del. 1993) (declaring "no special rules for a 'closely-held corporation'").

152. See Universal Studios Inc. v. Viacom Inc., 705 A.2d 579, 594-95 (Del. Ch. 1997) (holding joint venturers subject to fiduciary duty of loyalty but limiting it to terms of their non-competition clause); see also Ernst & Glover, supra note 44, at 11 (advising "giving the venture a sufficiently broad scope" and "restrict[ing] the partners' right to engage in activities within that scope," but also that "[p]artners should should establish exclusive arrangements only when necessary").

153. "The essential characteristic of a joint-venture is that unlike a hierarchy, there is no ultimate 'unity of command' and property rights and control are shared by the parent firms." Balakrishnan & Koza, supra note 31, at 101.

154. They are also sometimes called "hierarchies" because "equity joint ventures hav[e] governance attributes closest to those of internal organizations." Oxley, supra note 6, at 389. In corporate finance literature the internal organization (i.e., a firm) is often called a hierarchy. See WILLIAMSON, supra note 4. Calling joint ventures "hierarchies" is misleading, though. See supra note 153.
and rights (including profit shares) are spelled out by contract, or control is vested in one party. 155

Equity alliances are used when drafting and enforcing a sales or service contract could face three difficulties. 156 The first is "appropriability hazards" stemming from "weak property rights." 157 A partner may either free-ride by limiting its contributions to an alliance 158 or may appropriate know-how belonging to the other party or developed by the two parties jointly. This hazard is greatest when shirking or appropriation by a party is hard for the other to detect. The second is asymmetric information; that is, uncertainty about a partner's ability to help develop a new product or about the value of information held by the partner which cannot be fully revealed without undue risk that the first party can then appropriate the information. 159

The third difficulty is specifying duties when parties must coordinate their efforts; that is, "the anticipated organizational complexity of decomposing tasks among partners along with the ongoing coordination of activities to be completed jointly or individually across organizational boundaries and the related extent of communication and decisions that would be necessary," raising "an ongoing need for mutual adaptation and adjustment." 160 These difficulties are common when parties want to develop new technology together. 161 Specifying duties, for example, is complicated because the parties do not know how the project will evolve or what it will produce.

Equity sharing in alliances is often equated with a tight governance structure, but the two do not always go together. For example, "[r]epeated ties [between two parties] diminish use of hierarchical controls," 162 though not use of equity sharing. Also, "[w]hen there is trust, firms no longer consider hierarchical controls to be necessary." 163 It is unsurprising that these two factors have a similar effect because repeated ties enhance trust.

Governance features include "formal and informal monitoring or reporting requirements, provisions for third-party arbitration, details of assignments of managerial control rights, and the extent of effective hostage exchanges built into the

155. See Balakrishnan & Koza, supra note 31, at 100–01 (comparing joint ventures with "market mediated contracts").
156. See Oxley, supra note 6, at 388 (stating that "'hierarchical' alliances will be chosen for transactions where contacting hazards are more severe"); Sampson, supra note 141, at 3 (stating that joint ventures are more likely to be used "[a]s contracting difficulties rise"); see also supra notes 4–11 and accompanying text.
157. Oxley, supra note 6, at 388. She lists these "hazards" as: "adequately specifying payoff-relevant activities, monitoring the execution of prescribed activities, and/or enforcing contracts through the courts." Id. at 389.
158. Gulati, supra note 29, at 300.
159. See Balakrishnan & Koza, supra note 31, at 100.
160. Ranjay Gulati & Harbir Singh, The Architecture of Cooperation: Managing Coordination Costs and Appropriation Concerns in Strategic Alliances, 43 ADMIN. SCI. Q. 781, 782 (1998); see also Oxley, supra note 6, at 390 (referring to "the need for continued cooperation within the joint venture").
161. See Gulati & Singh, supra note 160, at 789–90, 804.
162. Id. at 807.
163. Id. at 790.
Several factors predict levels of hierarchy in an alliance, but there is no fixed pattern of governance features on a continuum from less to more hierarchy: "there is . . . considerable variation in the formal structures of alliances . . . ." Some variety may stem from economic change, like the growing importance of technology in alliances, but as experience teaches what terms work best, this variety may diminish. Much of the variety, though, grows out of underlying differences among alliances.

**Incentive Structures**

Again, strategic alliances feature different levels of trust, and even the highest level—norm-based trust—does not always induce optimal cooperation; even a normally virtuous partner may defect if the prospective rewards are high enough. Also, willingness to cooperate beyond the dictates of self-interest depends on a belief that the benefits of the alliance are shared fairly. Accordingly, partners need incentive structures that seem fair to both sides and that maximize the value of the alliance. Incentive structures depend in part on the form of entity.

In a joint venture partners share profits from one project. In a strategic investment (or "equity link") the investor has an interest in all the investee's profits. In a franchise, license, distributorship, or dealership, both parties hope to benefit, but they do not in the usual sense share profits.

Even after the form of entity is chosen, many decisions about incentives remain. In strategic investments, for example, the parties must decide not only what share of the investee's equity the investor will receive but also fix the investor's other financial rights. If the investee's fortunes fall, the investor may want it to dissolve and liquidate so as to recoup what remains of the investment. The investee's managers may want to continue the business, though, because they are playing with the investor's money. One way out of this dilemma is to give the investor a security with a liquidation preference so that losses are suffered first by the managers (who hold junior securities) and any salvage value in the firm goes first to the investor. Similarly, parties to an alliance often realize benefits at different times. A party who has already reaped its benefits may lose its commitment to its partner. For
instance, a distributor may incur large costs cultivating a market for a manufac-
turer's product and expect to recover these costs from its share of future sales of
the product. After these costs are incurred, though, the manufacturer may be
tempted to switch to a new distributor who has no such costs to recoup and may,
therefore, be willing to take a lower cut from sales.171

The alliance contract must deter such opportunism not only to avoid unfairness
to the distributor, but also to help ensure the manufacturer that the distributor
will not shrink from incurring the optimal expense to develop the market. One
solution is to provide for simultaneous performance or to segment performance
into small increments.172 For example, if one party provides all or most of the
capital, financing may be “staged”—that is, conditions must be satisfied before
each contribution must be made.173 The conditions must be carefully drafted so
that the financing party cannot withhold a contribution in order to force an op-
portunistic dissolution and the other party cannot demand further contributions
to a venture that seems unlikely to be profitable.

It may be wise for the party making the bigger contribution to receive hostages
from its partner. The ideal hostage is something that is not so valuable to the
recipient as to tempt it to breach the agreement and keep the hostage, but is so
valuable to the giver that it declines to breach lest it lose the hostage.174 Hostages
can be monetary, including performance bonds and escrow accounts. Because the
recipient cannot automatically and costlessly seize these monies, their benefit to
the recipient is less than their cost to the giver. Thus these devices serve the
purpose of encouraging the giver to perform without inviting the recipient to
seize the hostage opportunistically.

Also important are termination provisions that adequately credit the inputs of
each party.175 Like a liquidation preference, this ensures that the partner who
contributes more will get more back on dissolution.

Fairness does not always require equal sharing of benefits. For example, one
franchise of a supplier may fail while another franchise prospers under an identical
agreement. Franchisees' fortunes may differ because one has a better territory or
simply because it is more efficient.176 Parties should try to maximize the total
benefits of the alliance and agree “early on . . . that fairness in outcomes is needed

175. See infra text accompanying notes 212–26.
176. Franchise contracts give much of the alliance profits to the franchisee who, therefore, has strong incentives to succeed. See James A. Brickley & Frederick H. Dark, The Choice of Organizational Form: The Case of Franchising, 18 J. FIN. ECON. 401, 404–05 (1987); Holmström & Roberts, supra note 9, at 87–88.
to ensure each firm’s commitment... One principle... is to share gains in proportion to the value of your contributions.” 177 As this suggests, incentives should be tailored to the circumstances of each alliance. 178

REQUIRED PERFORMANCES AND THE SCOPE OF THE ALLIANCE

In defining duties in an alliance, a drafter must navigate between the Scylla of too little detail and the Charybdis of too much. Excessive detail may impose unrealistic burdens on a party and commit the venture to an unpromising path. 179 On the other hand, disappointment and disputes can occur when, for example, the know-how to be transferred to the alliance by one party is not adequately specified, and the know-how actually transferred proves to be less than the other party wanted and expected. 180

The scope of the alliance triggers more disputes than any other issue. 181 Too broad a scope may stop a partner from pursuing profitable opportunities alone or with third parties. It also increases the risk of appropriation of technical knowledge. 182 Too narrow a scope invites a party to usurp benefits that should be shared with the partner. The threat of such seizures can cripple an alliance by discouraging parties from sharing information or exerting their best efforts for the alliance.

Several facts may complicate the drafting of a definition of the venture’s scope. In research and development deals, “adequate specification of property rights will inevitably be problematic, since the contracted assets do not exist at the time the contract is written, and technological innovation is a highly uncertain process.” 183 The proper scope depends not only on the nature of the venture but also on the characteristics of the partners: “The opportunity set of each firm outside the particular alliance crucially affects its behavior within the alliance.” 184

As this suggests, the ideal scope of an alliance may change over time. Research and development take unexpected directions, as do product markets and competition. The partners’ outside activities may change. Their growing knowledge of each other also matters; as noted, alliances often begin small and hope that in

177. Lewis, supra note 51, at 23.
178. Thus, for example, franchise contracts for gasoline sales differ from those for repair services at automobile service stations. See Holmström & Roberts, supra note 9, at 87–89.
179. See Doz, supra note 38, at 67 (stating that one hindrance to cooperation in alliances was “a definition of the tasks to be performed, which did not do justice to their true complexity”); id. at 76 (decrying contracts that are “overly deterministic”).
180. See Oxley, supra note 6, at 393–94 (discussing difficulties in adequately specifying the know-how and rights to be transferred in an alliance).
182. See Joanne E. Oxley & Rachelle C. Sampson, The Scope and Governance of International R&D Alliances 4 (July 1, 2002) (unpublished manuscript, on file at http://pages.stern.nyu.edu/tsampson/scope7-02.pdf) (“The more extensive, complex, uncertain, and interdependent are the activities performed in an alliance, the greater is the potential risk of opportunism.”).
183. Oxley, supra note 6, at 394 (citation omitted).
184. Khanna et al., supra note 54, at 205 (emphasis omitted).
time mutual trust will grow and justify expanding the alliance. The drafter, then, must both define the initial scope of the venture and also provide good ways to revise that definition.

**GOVERNANCE MECHANISMS**

As noted, the utility of strategic alliances stems from the problems of both hierarchy (i.e., control over employees for things a firm “makes”) and contract (i.e., agreements by a firm to “buy” inputs in market transactions). While alliances, however, have proliferated recently, they still comprise a fairly small percentage of business activity. Further, most alliances terminate before reaching their goals. Clearly an alliance is not always preferable to making or buying inputs and, where an alliance is best, proper governance arrangements are crucial.

“50-50 alliances have a substantially higher success rate than joint ventures with uneven ownership . . .” Fifty-fifty ventures require mechanisms to break deadlocks, though. Moreover, one partner may reasonably demand more control if it is making a substantially larger contribution. In that case, mechanisms are needed to protect the minority partner against oppression. For example, the junior may have a right to terminate the deal on terms that make termination undesirable for the senior. Further, the controlling partner is subject to a heightened fiduciary duty, but that duty may be limited by agreement.

In some research and development alliances one party does most of the research while the other (usually the larger firm and a potential user of the product to be developed) provides financing. Instead of or in addition to such an arrangement, one company may make a strategic investment by purchasing stock of another firm that is developing technology of interest to the investor. Both these arrangements bear some resemblance to venture capital financings, so it is not surprising that firms providing funds borrow many control mechanisms used in venture capital deals.

**DISPUTE RESOLUTION AND AVOIDANCE**

Disputes between partners are inevitable and can shrink an alliance’s profits or turn them to losses, but fear of such damage does not always induce all parties

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185. See supra notes 38–39 and accompanying text.
186. See supra notes 4–10 and accompanying text.
187. See supra note 34 and accompanying text.
188. Ernst & Glover, supra note 44, at 7. “[T]he success rate is 60 percent for 50-50 deals, and 31 percent for ventures in which one parent has a majority stake.” Id.
189. See infra text accompanying notes 194–211.
191. See Terence Woolf, The Venture Capitalist’s Corporate Opportunity Problem, 2001 Colum. Bus. L. Rev. 473, 496–507 (discussing contractual waiver or modification of fiduciary duties); see also supra note 152.
192. See Lerner & Merges, supra note 17, at 145; Medearis & Hall, supra note 168, at 94 (“While the venture capital paradigm addresses a number of key elements [in a strategic alliance], it typically must be customized to address the concerns and motivations of each party.”).
to bargain reasonably. Sometimes people are simply unreasonable and reject measures that would benefit them. More importantly, protracted strife may weigh unequally on two partners. One side may deliberately precipitate conflict on some false pretext in order to force termination so it can grab the alliance's assets at a bargain. 193

Parties at odds can go to court, but litigation generally is slow and expensive, and generates conflict rather than harmony so that a suit between partners rarely ends with restoration of a happy, prosperous alliance. Moreover, judges may misunderstand a business dispute and resolve it poorly. Accordingly, it is usually wise for an alliance to have some mechanism to resolve disputes.

One solution is mandatory good-faith bargaining before some action (like filing a lawsuit or terminating the alliance) can be taken. Mandatory negotiations do not assure agreement, especially if one side decides to be obstreperous, but a duty at least to pretend to bargain in good faith may deter opportunism or facilitate a compromise that would not otherwise occur. 194 When an alliance is incorporated, the board may have neutral directors, who can resolve disputes or encourage the parties to behave reasonably so as to settle disputes themselves. 195

Many alliances (and other relational contracts) require arbitration of disputes. 196 The uses of arbitration, however, are finite. To compare matrimony again, no marriage benefits if one spouse calls a marriage counselor whenever the couple disagrees about what movie to see or what to eat for dinner. Arbitration clauses can cause parties to "exaggerate their claims and resist making concessions in order to offset their perceptions of arbitrator strategy—that arbitrators commonly 'split the difference' between the final positions of the two parties." 197

Arbitration can be helpful, though. Arbitrators sometimes try to restore cooperation. 198 They may also understand better than judges the parties' business goals. 199 "In addition, the parties may tailor the procedural rules in future arbi-

193. The default rules may legitimate this strategy. See supra note 21.
195. The very presence of neutral directors promotes moderation, especially if parties value their reputations. Neutral directors also act as mediators, urging conduct to facilitate settlement. One possible problem is that a supposedly neutral director may be influenced to side repeatedly with one party, as happened in Lehman v. Cohen, 222 A.2d 800 (Del. 1966). Accordingly, it may be wise to require unanimous approval of the neutral director each year, although that could lead to the very deadlock that a neutral director is supposed to prevent if the parties cannot agree on choice of a neutral director.
196. See Bernstein, supra note 102, at 241 (stating that alternative dispute resolution arrangements are favored by many parties, including many large corporations).
197. Neale & Bazerman, supra note 73, at 37 (citation omitted).
198. See Bernstein, supra note 30, at 1785. In general, arbitration increases social welfare. Id. at 1788 n.237.
199. See Triantis, supra note 47, at 7 ("[F]actors that are nonverifiable before a judicial court may be verifiable to a specialized arbiter. Vague terms such as 'reasonable' may have a more precise meaning to an arbiter than a judge and can therefore police a larger range of conduct.").
A partner who incessantly demands arbitration, though, would probably cause even more trouble if arbitration were not available.

Lawyers are well acquainted with dispute resolution devices; they know much less about dispute avoidance techniques. This may be appropriate. As noted before, "legalizing" a relationship can impair needed trust and cooperation. Sometimes, though, contract terms can enhance cooperation and reduce friction. The analogy of business alliances to marriage is imperfect because alliances are formed without the parties being in love or even knowing each other well. Alliances often begin as hesitant trials with hopes that initial success will warrant a deeper and broader deal later. When allies are still unsure of each other, contract devices may nourish trust and cooperation.

What are these devices? Lawyers prize precision and enforceability in contracts, but terms that are vague and only aspirational may suit strategic alliances. Some experts recommend terms declaring the "centrality of trust in the relationship" and "that success will depend on continuing cooperation, which cannot be fully specified." Though unenforceable, such terms may sway a court or arbitrator to construe broadly the parties' fiduciary and good faith duties. Further, such terms may influence the parties' norms because most people want to keep their promises. They remind those who negotiated the deal and inform later arrivals of the attitudes the parties agreed to strive for.

Contracts can also foster communication that improves cooperation. "Frequent, repeated and multifaceted contacts among organizations and an open exchange of information increase the possibility of trust building . . . ." Some contracts provide for periodic meetings between the allies and stipulate attendance by senior managers so as to establish, at high levels, a commitment that will filter down to

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200. Id. For example, parties with valuable knowledge can keep arbitration private and confidential to an extent that is difficult or impossible to achieve in litigation.

201. See supra text accompanying notes 48–53.

202. See supra notes 38–39 and accompanying text.

203. See TRIANTIS, supra note 47, at 5 ("Contracting parties will not condition their legal obligations on nonverifiable factors because of the enforcement obstacles raised by the difficulty in verifying the state to a court."); Alan Schwartz, Relational Contracts in the Courts: An Analysis of Incomplete Agreements and Judicial Strategies, 21 J. LEGAL STUD. 271 (1992).

204. LEWIS, supra note 51, at 265.

205. Thus such terms may resemble the ubiquitous "whereas" clause which is not itself enforceable but which may influence judicial interpretation of the contract. See JOHN EDWARD MURRAY, JR., MURRAY ON CONTRACTS § 88B, at 422 (3d ed. 1990) ("These clauses are viewed as persuasive but not controlling in determining the intention or purpose of the parties.").

206. See TRIANTIS, supra note 47, at 10 ("The parties may use a vague term to communicate intentions and expectations to each other or even to their own co-workers or agents . . . .").

207. Sydow, supra note 65, at 48; see also Good, supra note 104, at 36 ("[T]he greater the amount of communication there is between the players in a wide variety of games, the greater the likelihood of there being a mutually beneficial outcome."); Gulati, supra note 29, at 306 (one factor that correlates with success in alliances is "regular information exchange with the partners"); Cynthia Hardy et al., Distinguishing Trust and Power in Interorganizational Relations: Forms and Façades of Trust, in Trust Within and Between Organizations: Conceptual Issues and Empirical Applications, supra note 35, at 64, 71 (advising partners to "strive for a communicative ethic"); Lorenz, supra note 39, at 207 (members of business networks invariably "stressed the need for personal contact" as well as faithful contract performance).
lower employees. Provision can also be made to require discussion whenever either party requests it.208

If one party has valuable knowledge, though, the other must be prevented from seizing that information for its own benefit. Confidentiality agreements may help inhibit this occurrence.209 Monitoring can enhance trust by relieving fears that a partner is cheating.210 Monitoring can also erode trust, though, by creating fears that a partner is spying, trying to seize sensitive information that it can use opportunistically.211 Such information can include not only technical know-how, but also information about the partner. For example, a party that learns that its partner has financial troubles could exploit that knowledge to force a one-sided termination or revision of the agreement.

If partners are deeply divided, though, no contract term can restore cooperation. Termination is then necessary.

TERMINATION

Ironically, the most important provisions in most alliance agreements are those governing termination.212 This is so for four reasons. First, at termination the stakes are often huge. If one partner can grab most of the alliance's benefits cheap, the other may suffer a big loss in a venture that could and should have been profitable for both. Second, the possibility of an opportunistic termination can undermine a collaboration that could profit both parties.213 A research firm, for example, will not exert its best efforts for an alliance if it fears that its partner can seize the fruits of its research at a bargain price.

Third, the default rules for termination are totally unacceptable for many alliances. For instance, in partnerships (including true joint ventures) any partner can dissolve at any time and force an auction of the firm's assets unless otherwise agreed. Finally, termination is almost inevitable and usually occurs when the parties are not feeling generous. A major motive for cooperation in alliances is each party's hope for the venture's success. When termination looms, that motive is gone. Moreover, although alliances sometimes end happily when all goals are met or one partner acquires the other, termination over disputes or dissatisfaction is more common. The parties then may not voluntarily be fair and reasonable; sound contract terms are needed.214

208. This resembles a requirement for mandatory bargaining. See supra note 194 and accompanying text.
209. See Lewis, supra note 51, at 12 (referring to use of confidentiality agreements).
210. See Helper et al., supra note 38, at 443, 472 (claiming that monitoring raises trust by limiting opportunism); see also Good, supra note 104, at 37, 45.
211. "Too close and all encompassing an interface may also block learning." Doz, supra note 38, at 75. Parties may feel "threatened by the need to make early commitments ... ." Id. at 75-76.
212. See Harrigan, supra note 23, at 365 (stating that lawyers consider termination clauses "very important" and devote eighty percent of joint venture agreements to them). More joint ventures have no exit mechanism, though. See Glover, supra note 181, at 8.
213. See Lewis, supra note 51, at 48 (trust won't help "when one of you is heading for the exit").
214. See supra note 21 (concerning dissolution and liquidation). Further, before distribution of any surplus, the capital accounts must be repaid. Unif. P'Ship Act § 18(a) (1914), 6 U.L.A. 101 (2001);
Exclusive agency and distributorship arrangements are also generally terminable at will. To have a successful alliance, parties “must be able to punish partners for acts of opportunism and gaming.”

Termination is an issue on which lawyers can claim and prove their value in creating alliances. Business people expecting a prosperous venture often think little about termination before a lawyer arrives, yet they can hardly deny its importance.

Most alliances end with a buyout. A buyout can be arranged without prior agreement, but it is likely to be more satisfactory if arranged in advance. If both parties are well financed they may agree to a Russian roulette buyout. If one partner is not well financed it may be better to provide for a buyout by the wealthier party at a price fixed by appraisal or a predetermined formula. Because parties may make their contributions to the alliance at different times, one party may be tempted to terminate at a time when it has made less of its contribution than the other party has. Accordingly, termination provisions should take account of the contributions.

Instead of or in addition to a buyout the parties may provide for transfer of some or all alliance assets to the parties. If, for example, one party contributes some intellectual property (like a license or patent), the agreement may provide for that property to be returned to the contributor on termination.

Because termination clauses are intended to promote stability and deter opportunism, provisions may vary depending on which party terminates and when. In a Russian roulette buyout, for instance, the party that terminates must give the other party the choice to buy out or sell out. Uncertainty of what the other party will do may discourage terminations. Although courts will not enforce a penalty, they do uphold provisions for grossly disproportionate divisions of firm value.

**Unif. P'ship Act § 401(b) (1997), 6 U.L.A. 133 (2001).** If partners are not careful at the outset in setting up their capital accounts, there may be litigation and unfair results in the valuation of contributions of services or of property other than cash. See Dent, supra note 3, at 99–100.


217. See Lewis, supra note 51, at 48 (good termination clauses are crucial even though “discussing termination when you are trying to develop faith in each other could invite hard feelings”); see also Ernst & Glover, supra note 44, at 13 (“suggesting exit provisions ... seems like an act of bad faith”).

218. See Ernst & Glover, supra note 44, at 12 (in one study seventy-five percent of joint ventures ended with a buyout).

219. See id. at 98–99 (describing this device).

220. This principle is reflected in partnership law, which provides for return of capital contributions before division of any surplus. See supra note 214 and accompanying text.

221. See Medearis & Hall, supra note 168, at 106 (describing “rubber band” clause providing, for example, for return to a party of technology that it has contributed to the alliance).

222. See supra note 219.

223. See Calamari & Perillo, supra note 48, at 589–90 (“[C]ourts have assiduously continued to refuse enforcement of penalty clauses ...”).

224. See Gevurtz, supra note 22, § 5.3.1, at 523 (“[C]ourts usually have upheld first options [to purchase a shareholder’s stock] despite arguments that the price was so much less than the value of the shares as to render the restriction unreasonable.”).
Such provisions may be undesirable, though. A partner may want termination because it sincerely feels the alliance is unfair or unprofitable or because it wants to accept a third-party bid to buy the assets of the alliance. In sum, lawyers must take care that termination is neither so easy as to invite opportunism nor so difficult as to lock a party into a bad arrangement.

Another deterrent to opportunistic dissolution is a lengthy notice requirement, sometimes called an "evergreen" clause.225 *Inter alia*, the notice period allows the weaker party to seek financing (which may come from a new partner) for a bid if the assets of the alliance are to be auctioned or if there is a Russian roulette buyout provision. Lengthy notice requirements are not always desirable, though. For example, some experts recommend provisions allowing prompt termination by a licensor.226

**Implications for Legal Training**

Law schools have long had a bias toward litigation at the expense of planning and negotiation. This bias stems from several sources: the continuing dominance (especially in the first-year curriculum) of the case method, which studies law through judicial decisions in litigated cases; the overrepresentation on law faculties of specialists in litigation-oriented fields (like torts, constitutional and criminal law, and procedure) as compared with specialists in fields like business, tax and commercial law and estate planning that invite more attention to planning and negotiation; and the interest of most scholars (including those in the latter fields) in legal doctrine, which focuses on debates over legal interpretation and policy in litigation and legislation, rather than on the practice of law.

The growth of strategic alliances makes this bias more troubling and also creates new problems for both law schools and continuing legal education. This section discusses these new problems. These demands on lawyers are not unique to strategic alliances. In family and labor relations, in nonprofit member organizations, and indeed in all of politics, trust (or, if you prefer, risk management) promotes success. Discussion of these fields is beyond the scope of this Article, but the similarities make the need for change in legal education all the more pressing.

**Contracts and Business Organizations**

The growth of strategic alliances calls for revision of the old axiom of contracts courses that the more precise and detailed the contract, the better.227 Of course, this principle has long been subject to the qualification that the benefits of a provision must exceed the costs of its negotiation and drafting. The lesson from strategic alliances adds a new twist to this qualification: Where parties will need to cooperate and to trust each other after signing, the tendency of hard, protracted bargaining over details to defeat this goal must be counted among the costs.

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227. See *supra* note 47 and accompanying text.
Another implication is that some contracts need flexibility to allow adjustment to changing circumstances. This need is not unique. Output and demand contracts, for example, do not fix in advance the quantity of goods to be supplied but permit one party to decide the quantity at a later date. Some sales contracts also base price on market conditions. Again, though, strategic alliance contracts add a new twist by introducing concern for the changing level of trust and cooperation. Of course, parties can always tear up a contract and create a new one if after some experience they want to change their relationship. The challenge is to provide terms (like mandatory bargaining\textsuperscript{228}) that facilitate profitable revisions without inviting opportunism.

A further implication is that the line between contracts and business organizations has eroded. Of course, business organizations have always used contracts; a corporate charter is itself a contract, as are shareholder and partnership agreements. These contracts are quite distinct from sales and service contracts, though. Franchises, licenses, dealerships, distributorships, strategic investments, and other strategic alliances do not fit into the old categories. Alliances are rarely covered in law schools today because they don't fit within traditional commercial transactions or business associations courses. Existing courses should be augmented or new courses created to plug this gap.

**Negotiation**

Only recently have law schools and continuing legal education begun to cover negotiation. The new programs are commendable in part because they try to curb aggressive bargaining. Again, strategic alliances add a new twist. Current programs teach that politeness helps to reach agreement, to get to "yes." The final goal, though, is still to get one's client the most favorable terms, regardless of whether the other party learns to mistrust one's client or considers the terms unfair either at the signing or later. Thus, for example, it is fine to withhold crucial information during negotiations. In strategic alliances, though, such behavior may be undesirable because the other party's trust will evaporate if it learns the information after signing.

**Diversity**

It is now a common canard in academia that ethnic and gender diversity is a source of strength in human relations. The popularity of this bromide is remarkable because it is transparently false—experts in many social sciences know that this diversity is an obstacle to smooth, beneficial collaboration. People tend to trust others who resemble themselves and to suspect those who are different.\textsuperscript{229} Thus, especially where the rule of law is weak, commercial dealings are

\textsuperscript{228} See supra note 194 and accompanying text.

\textsuperscript{229} See \textsc{Lee Gardenswartz} \& \textsc{Anita Rowe}, Diverse Teams at Work: Capitalizing on the Power of Diversity 63 (1994) ("As human beings, we tend to gravitate toward what is familiar and predictable because it is comfortable. We also tend to shy away from and mistrust what is different . . . ."); see also \textsc{Lee}, supra note 51, at 15 ("The potential for trust between firms is higher the more that both have in common; it is limited by any differences.").
often concentrated within clans or ethnic groups because their homogeneity enhances trust.230

This does not mean that transactions among different people should be avoided. One reason for the growth of strategic alliances is economic globalization; transnational alliances have grown even more rapidly than domestic alliances.231 Firms can profit from globalization, but to do so they must realize that diversity is not a benefit but a liability and learn how to overcome it.232 A problem recognized is an opportunity. Thus, lawyers who can build trust will be valuable, and if the legal profession can inculcate this skill widely, not only can some of its members reap handsome fees, but the profession itself may come to be seen less as sowers of conflict and more as peacemakers and benefactors.

Basic principles for handling diversity are well known. First, the parties must show each other that they share key values. Some values, such as respect for one's partners, openness to their views and generous sharing of information, are manifested (or negated) in negotiations.233 "We tend to trust people who confide in us, who explain the reasons for their behavior, and whose motivations we can understand."234 At the same time, the parties need "[a]n understanding of [their] different cultural norms and their impact on communication, problem solving and conflict . . . ."235 "Cultural differences often cause us to attribute different meaning to the same set of facts."236 "[T]here is a strong tendency for ambiguous or incomplete information to be interpreted in line with the individual's preconceptions."237 Because contractual incompleteness is common to alliances,238 parties should air these differences during negotiations and agree how to resolve them so that trust is not later shattered by disappointed expectations. Because lawyers draft contracts, it is especially important for them to attend to this need. At the same time, though, negotiations must not fall into contentious haggling or de-

230. See Donald McCloskey, Bourgeois Virtue, AM. SCHOLAR, Spring 1994, at 177, 183–84 (explaining that exchange is often focused within an ethnic group because of trust); Ronald Wintrobe, Some Economics of Ethnic Capital Formation and Conflict, in NATIONALISM AND RATIONALITY 43, 46–47 (A.G. Breton et al. eds., 1995) ("The costs of trust formation are lower when the two parties share common traits, such as common language, ethnicity, and so on.").


232. See, e.g., GARDENSWARTZ & ROWE, supra note 229 (taking just this approach).

233. See id. at 25 (stating that there must be a "set of shared values that clearly articulate demonstrations of dignity and respect"); see also id. at 149–50 (stressing the importance of mutual respect and accommodation).

234. Id. at 114.

235. Id. at 25.

236. Susan Bryant, The Five Habits: Building Cross-Cultural Competence in Lawyers, 8 CLINICAL L. REV. 33, 42 (2001); see also GARDENSWARTZ & ROWE, supra note 229, at 46–47 (misunderstandings often arise when parties have different belief systems).

237. Good, supra note 104, at 41.

238. See supra notes 15–16 and accompanying text.
manding one's terms without sensitivity to the partner, both of which are common to lawyers. 239

How these principles apply depends on context. How are the parties diverse, and what are their goals? 240 In addition to the indispensable values of respect and openness, business people from different backgrounds may share such values as a commitment to high product quality and dedicated customer service. Activities (like plant tours) that seem superfluous in other situations may help demonstrate these shared values when the parties are diverse. Common personal interests (like sports or music) can also forge bonds between diverse parties, which makes personal contacts between them more important than they otherwise are.

As noted earlier, 241 these goals place a premium on the parties' demeanor in negotiations. They should eschew self-interested hard bargaining and instead cooperate to maximize their total gain and share it fairly. Indeed, diverse parties need a distinct concept of what constitutes negotiations. They should not only discuss contract terms in a conference room but socialize; personal contact can always improve trust and is essential when parties belong to different groups. 242

To show shared values and understand differences takes time. "[T]rust builds slowly, through a series of shared experiences in which expectations are met, belief in each other is validated, and individuals find they can depend on the predictability of each other's behavior." 243 Thus, the more diverse the parties, the longer negotiations are likely to take.

Trust remains important and changeable after a contract is signed. Parties often start small and hope over time their trust will grow so as to justify expanding their collaboration. 244 The growth (or decline) of trust depends on the parties' behavior, including both their sincerity and competence in performing contractual duties. Respect for the other's views, generous sharing of information, and cooperation and fairness in solving problems are especially crucial in an alliance between diverse parties.

Even in an alliance of big organizations, trust is largely between individuals. When new people become involved in an alliance, trust is likely to shrink unless the parties take deliberate steps to preserve it. Thus, personal contact must be maintained over time. The importance of the alliance and of honoring the partner's trust must be communicated anew from each party's top management as the alliance receives new participants.

Many of the foregoing measures for nurturing trust were stated earlier, but this does not mean that diversity is irrelevant to trust. Rather, the specific steps needed for trust differ when the parties are diverse. Moreover, there are different kinds of diversity, and they demand different approaches to trust. 245

239. See supra notes 43–46 & 75–80 and accompanying text.
240. See GARDENSWARTZ & ROWE, supra note 229, at 31–57 (discussing different kinds of diversity).
241. See supra notes 101–27 and accompanying text.
242. See Lorenz, supra note 39, at 207 (emphasizing the need for personal contact).
243. GARDENSWARTZ & ROWE, supra note 229, at 110.
244. See supra note 39 and accompanying text.
245. See GARDENSWARTZ & ROWE, supra note 229, at 31–57 (describing different kinds of diversity).
This approach to diversity is the antithesis of the current academic fad of "multiculturalism" which advocates that each "identity group" focus on its own separate culture. Transnational alliances and trade have grown most rapidly among people who share certain values already much alluded to in this Article: honesty, openness, receptivity to the views of others, and fairness. If the legal profession wants to advance the role of lawyers in developing strategic alliances, it should promote these values among its members. That will often require retraining people who have been steeped in the separatist, identity group attitudes of multiculturalism.

**CONCLUSION**

Old habits die hard. The training and experience of most lawyers inclines them to be adversarial and obsessed with details. These habits cause trouble in negotiating and drafting for strategic alliances. This Article has described these problems and shown how lawyers can resolve them. It has also discussed how legal education should change to help prepare lawyers for this practice. By so doing lawyers will enhance their own fees and the prestige of the profession. They will also improve the functioning of business alliances, which have become so important to the American and global economies.