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Technological innovation and globalization have led to a proliferation of strategic alliances. However, many business people are still skeptical about the role of lawyers in strategic alliances. Business people often feel that lawyers are deal breakers, not dealmakers. Jim Freund, who has written a lot about negotiations, says that business people rail at the negative attitudes lawyers exhibit, such as seeing a problem behind every bush, overcompensating to avoid risk, and generating conflict.[1]

Also, business people often fault lawyers for failing to understand the client's business needs and objectives. This problem is especially acute in the context of strategic alliances. In many transactions, the business goal of the client is pretty obvious. In a strategic alliance, however, it is much less obvious because there are number of reasons why a client might enter into an alliance: a client might want to develop a particular product or develop knowledge of technology in a particular field; a client may be looking to commence what it hopes will be a growing relationship with a partner to establish a presence in an industry; or a client may be looking to an acquisition down the road. Since the range of goals in a strategic alliance is quite broad, lawyers need to pay attention to their client and to the business context of the transaction.

To be fair, some of the fault lies with clients. First, they sometimes discuss deals at a level of glittering generalities until the lawyers arrive and start raising tough questions: What if the alliance terminates; what happens then? The parties fall to squabbling, the deal falls apart and they say, "Oh gee. Things were going so well until the lawyers came here and messed it up." Of course the problem was that the lawyers raised the tough issues that the parties themselves had not bothered to address.

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[1] JAMES FREUND, SMART NEGOTIATING: HOW TO MAKE GOOD DEALS IN THE REAL WORLD 186 (1992).

Also, some of the fault for the lawyers' failure to understand the business context of the transaction and the goals of the client rest with the client. The client needs to consult with and discuss these issues with the lawyer since that's the only way the lawyer can know what the client's goals are. Ed Bernstein has written about how lawyers can take the blame if clients suffer a loss from an event for which the lawyers did not draft.[2] There have been some suggestions that often parties do not want a complex detailed contract. They want a simpler contract because they don't want the hard bargaining that will erode trust, and they also want to maintain flexibility, which is understandable. On the other hand, the lawyer who drafts the contract may realize that if the contract does not cover some point and later the lack of a term becomes the cause of conflict, everyone is going to blame the lawyer.

So what do you do as the lawyer if the parties are asking you to draft a flexible, simpler contract, but if you leave something out, they are going to blame you for it? First, some background before discussing how to tackle this problem: I mentioned earlier the traditional dichotomy that if you need goods or services you either buy them or make them. The strategic alliance is a third way. Why? They are used when it is not practical to hire people.

As mentioned earlier in this symposium, there was a trend a few years ago where many employees left big firms and formed a little start-up firm, and then entered into a joint venture with a big firm because the people in the little firm are going to be making all of the money.[3] It is hard, and maybe in many cases impossible, to give a big company's employees the same compensation incentives that a joint venture partner has. Therefore the option of making goods is not practical. And on the other side – we heard references to this earlier – the market contract does not work in situations where the nature of the required performances is too complex or too contingent to be spelled out in a contract.[4] At the same time, lawyers often feel uneasy when a contract specifies that the performance required on one side is to use "best efforts." What does that mean? How are you going to monitor that to prove it? But it is not an uncommon feature. Of course, what it means is that en-

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[2] *See* Edward Berstein, *Law and Economics and the Structure of Value Adding Contracts: A Contract Lawyer's View of the Law and Economics Literature*, 74 OR. L. REV. 189, 235-36 (1995).

[3] *See* Stephen Fraidin, Remarks at the George A. Leet Business Law Symposium, *The Role of Lawyers in Strategic Alliances* 15-16 (Oct. 4, 2002) (transcript available from the Case Western Reserve Law Review).

[4] *See* Susan R. Helper, *Governing Alliances: Advancing Knowledge and Controlling Opportunism*, 53 CASE W. RES. L. REV. 929, 933-34 (2003).

forcement is not a realistic possibility. You have to rely on trust and cooperation and a structure that is conducive to using best efforts, as opposed to relying on an ability to sue for damages for breach. Therefore, it follows that alliance agreements are often quite vague. Each party's duties are so vague and complex that it is often impossible for a party to detect and prove to a court that the other side is not meeting its obligations.

Accordingly, in alliances parties cannot rely on the usual means to enforce the contract, but must instead rely on trust, which has to be cultivated before the parties can even enter into an alliance, and which has to be preserved and even enhanced if the alliance is to realize maximum profits. The obligations of trust and cooperation cannot be spelled out. These are difficult concepts for lawyers, who are trained to get everything in writing. How does a lawyer draft trust and cooperation into a contract? Either you don't at all, or you put the terms in – and they can be very useful since people like to think of themselves as abiding by their promises. So, if you put in provisions that say, "We'll use best efforts and we will act in a cooperative way," they indeed have some influence, even though they are basically unenforceable.

The hard bargaining over details so admired by lawyers erodes the trust and cooperation that the parties want to nurture. Steve Fraidin mentioned the talks among the business people before the lawyers get involved.[5] Those discussions often include dining together, playing golf together, drinking together, and trying to avoid unpleasant disputes. Then the lawyers enter and say, "All right, what are we going to do about this clause here. This is unacceptable. We need to revise this." What happens to all the trust and the buddy-buddy relationship that the parties have been trying to cultivate? How can lawyers make clients happy?

First, consult carefully about what your client wants and how the client wants to achieve it. A lot of lawyers are like the driver who is lost but refuses to ask directions because asking for directions might make you look foolish. If you are in litigation and you are representing the plaintiff, you do not say to the plaintiff, "What's your objective here?" If you did, the client might answer: "The objective is to win the suit and get as much money as I can, obviously. Why are you asking me such a stupid question?" But in the context of a strategic alliance the goal is not so obvious, so a lawyer should not be embarrassed to say to the client, "Let's talk about what your objectives are here." Again, the parties want to

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[5] Stephen Fraidin & Radu Lelutiu, *Strategic Alliances and Corporate Control*, 53 CASE W. RES. L. REV. 865 (2003).

create a relationship of trust and confidence, so as the lawyer you need to discuss with the client what the client's goals are and what parameters there are in terms of the negotiations in order to create and maintain that relationship.

One expert has said the first rule of outside counsel is to know your client. In this respect – with apologies to Steve Fraidin, who objected to the comparison[6] – the strategic alliance is something like a marriage, and the lawyer in the alliance may be compared to a lawyer in a prenuptial agreement. Couples who want a prenuptial agreement differ about what issues they want the agreement to cover. If somebody just says to you "draft a prenuptial agreement," you'd say, "it's not a standard form contract. I'd have to sit down and talk with the clients. Why do you want this and what do you want to cover?" The same thing is true with an alliance.

Trust is not an all-or-nothing quality. It comes in shades of gray and changes over time. Partners in alliances often start small with the hope of expanding their cooperation if trust in each other is vindicated. This is something sociologists talk about as a way of developing trade in primitive cultures. How do you deal with another tribe that is unknown to you? You start small with some little trades, and if that works out, you move on to bigger ones. Similarly, partners in alliances often start small and hope to expand. You cannot know what your client wants unless you know what level of trust the parties already have. What is your past relationship with these people? What is your feeling about them? What is your basis for trust in them? Do you know them from the industry? Is this a close-knit industry in which people care about their reputation? Is this a firm that has a reputation that it wants to preserve? Or is it a start-up firm that may not have any reputation and may not much care about what reputation it develops?

Again, lawyers tend to assume that clients want them to bargain hard over details. That's what lawyers usually do. Also it's natural for lawyers to get involved in a matter and want to justify being there. Why am I sitting at the table? What is my purpose? My purpose is to bargain hard over details. But in the context of strategic alliances, that may not be what the clients want. In many cases if the lawyer does not bargain hard, she is considered to be a "chump." "Here we are bargaining hard, and the other guy's not saying anything. She's not much of lawyer." But in the context of an alliance it may be that the hard charging, hard bargaining lawyer is not what the client is looking for. To put it another way, the

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[6] *Id.*

role of the hired gun is not really appropriate in many cases here. The goal is to obtain the mutual satisfaction of the parties. That doesn't necessarily mean splitting the difference where goals conflict. As business people point out, to divide the baby in half often leaves both sides feeling compromised. Negotiators, including the lawyers, should try to find out what issues are important to each side and see if they can get what their clients want and what is important to their clients, while at the same time, giving the other side what is important to them.

The parties should seek creative win-win solutions that expand the total pie. In his valuable book, *Trusted Partners*, Jordan Lewis quotes one veteran: "The attorneys on the other side and I see each other as partners, facilitating a mutually beneficial business arrangement."[7] To go back to the model of the litigator, you're fighting over a pie with a fixed size. The only way I can get a larger slice is to take it away from you, and the only way you can get a larger slice is to take it away from me. But in the context of an alliance, it may well be that the transaction can produce either a larger or a smaller pie. Therefore, lawyers should think about how they can structure a transaction that will produce a larger pie and, therefore, a larger slice for each participant. In some cases that may require offering the other side concessions it hasn't even requested. Partners in strategic alliances often differ widely in their sophistication and bargaining power. The usual attitude of lawyers in that situation is: "We've got bargaining power over these people. Well we're going to exploit it to the hilt." In the context of an alliance, though, the objective is not to get the most attractive deal on paper, but to get the maximum contribution from the other side. To do that it may be wise not merely to accede to certain demands by the other side, but perhaps even to suggest them. Again, if we use the model of marriage, sometimes it can pay dividends to do something nice even when you're not expected to do it.

There was discussion earlier in the symposium about flexibility.[8] We all know what happens in the evolution of legal documents. They get longer over time. The ability to spot issues and to draft precise clauses to cover a myriad of contingencies is a point of pride for many lawyers. You take what was an eighty-page document in the last deal and make it an eighty-five-page

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[7] JORDAN D. LEWIS, TRUSTED PARTNERS: HOW COMPANIES BUILD MUTUAL TRUST AND WIN TOGETHER 262 (1999).

[8] Sanjiv K. Kapur, *Structuring and Negotiating International Joint Ventures: Anecdotal Evidence from a Large Law Firm Practice*, 53 CASE W. RES. L. REV. 937 (2003).

document by adding some provisions to cover something that no one thought of last time. In many contexts, such work may be the mark of a great lawyer, but in strategic alliances, parties often prefer simple contracts. For one, they're cheaper to draft. Simpler contracts also provide greater flexibility. By contrast, proposing detailed terms may provoke suspicion that you're not going to try to work problems out cooperatively, but you're going to stand on your contractual rights. The reaction of the other side is often: "Wait a second. I thought we were going to be buddy-buddy here and you're haggling over the details of the contract. Does that mean you're going to look for every opportunity to drag this into court? That's not the kind of relationship we have in mind."

It was mentioned earlier that most alliances end in divorce, usually in a few years.[9] The reasons vary, but they often involve opportunism. Therefore, a client is justified being wary of the other side. On the one hand, you can't assume an adversarial relationship. But on the other hand, you can't assume a buddy-buddy relationship. In these situations people often use the phrase "calculative trust," which is based on a determination that your partner has a strong self-interest in performing in good faith. For example, a party cooperates because it wants future business with the partner or because it wants to maintain its reputation, especially in a close-knit industry. Of course, if such factors are absent, there may be less reason to trust the other parties. As always, the lawyer has to ask the client what reason there is to think that the other side is going to perform in good-faith and use its best efforts. Will a concern for its reputation cause the other side to perform in good faith? Or are such factors absent so that the lawyer will have to draft it into the contract?

The scope of the lawyer's advice may depend on the sophistication of the client. Consider the line between business questions and legal questions. If your client is a large firm that has a lot of experience with alliances, the client will know what they want and will be able to tell you in reasonable detail what they want. On the other hand, if the client is a start-up company without much sophistication in legal matters and with no experience in alliances or any other kind of transaction, then the lawyer may have to serve in a much broader capacity, such as providing business advice as well as technical legal advice.

The substantive terms of an agreement are just as important as the negotiation demeanor used to reach an agreement. The two,

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[9] *Id.*

however, are closely related. For instance, the calculative trust used in negotiations may depend heavily on the substantive terms of the contract. Of course, the first question – on which the attorney may or may not be consulted – is whether to enter into the strategic alliance at all. Rachelle Sampson spoke about this and the need to not assume that an alliance is always the best arrangement to enter into.[10] It may be that some kind of service or purchase contract would be a better arrangement in a particular situation.

In addition, there is always the option of foregoing an alliance and making the desired goods or creating the desired service in-house. If another firm has something you want, some technology you want, maybe you can just purchase it from them. If they have some employees you want, hire them. If you do not want just part of the company, acquire the whole company and do not bother with an alliance. In fact, many alliances are in effect trial marriages that culminate, if things go well, with one firm acquiring the other. But the parties often want to get to know each other before stepping to the altar. And in many cases you don't want an entire firm but only part of it, or it is impractical to the give the employees the same material incentives that an independent firm perhaps can in an alliance.

The parties must choose what form the entity should take. The choice may be important for reasons of tax treatment, fiduciary duties, and legal liability of the partners. For example, many alliances are referred to as joint ventures. A true joint venture is generally treated in law as a partnership, though, in fact, many so-called joint ventures are incorporated and therefore treated as corporations. Recall that a partnership is defined as an association of two or more persons to carry on as co-owners a business for profit.[11] So, if you have a sharing of control and profit, you may have partnership even if you call your arrangement a dealership, a distributorship, or something else. How will your income be allocated? For instance, division of profits may be the most important factor to deter one partner from forcing an opportunistic dissolution. In addition, it may be wise to give one partner a liquidation preference on some or all of the alliance assets.

There are questions at every stage. For instance, if the entity will incur losses, as is common at the start of a project, how will

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[10] Rachelle C. Sampson, *The Role of Lawyers in Strategic Alliances*, 53 CASE W. RES. L. REV. 909, 925 (2003).

[11] UNIF. P'SHIP. ACT § 6(1) (1914); 6 U.L.A. 256 (1995); UNIF. P'SHIP. ACT § 101(6) (amended 1997), 6 U.L.A. 37 (Supp. 2001).

the resulting tax deduction be divided? Remember that to maximize the client's profit the lawyer needs to give the other side the right incentives. So, for example, in franchises it is usually the franchisee who gets the lion's share of the variable income. The franchiser sells the product at a fairly fixed price. Why is that? Because the franchisee has more influence over the sales from each franchise. You try to place the incentives with the partner who has the most influence over the outcome. Remember that an apparently attractive profit sharing clause is of little use if the other party can back out on terms unfavorable to your client. Also, termination provisions haunt the income sharing provisions and all other contract clauses.

The scope of the alliance can be narrow or broad. One writer says this issue triggers more disputes than any other.[12] A broad scope may prevent a partner from pursuing profitable opportunities alone or with third parties while a narrow scope invites a party to usurp benefits that should be shared with the partner. An example of the latter would be one firm taking technology developed by the partner for one purpose and using it for another purpose without sharing the profits. Drafting to address such problems can be difficult. How can you define the scope, for example, of a research and development joint venture when you can't be sure what results the venture will produce? It is very common for research that begins with one objective to discover technology that is useful in some other way. How do you contract for that, when by definition you don't know what the results are going to be?

Also, the ideal provision may change over time. For example, suppose one partner enters into a new line of business. A lawyer would now have to revise the alliance contract to take that into account and decide if the new line of business is within the scope of the venture or is not, and, therefore, is or is not within the scope of the fiduciary duties.

What about governance? Who calls the shots here? Even if one party has general control, there are ways of softening the effects of this so that the party cannot abuse its power. For example, the controlling party may agree to consult with a junior partner before taking specified steps. Of course, an obligation to consult, technically, does not limit the controlling partner's power. But as a practical matter, if people are required to consult with somebody else they tend to be more reasonable and more cooperative.

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[12] Steven I. Glover, *Negotiating and Structuring Joint Ventures: Lessons from Management Consultants*, M & A LAWYER, Mar. 1998, at 1, 7.

There is some evidence that fifty-fifty joint ventures tend to be more successful than others. That is not surprising. I think equality is easier to deal with than domination of one party by the other. But, of course, equality in regards to control raises the specter of disagreement and deadlock. How can a lawyer deal with that? An obvious solution is arbitration. But as was mentioned earlier in the symposium,[13] although arbitration is not as divisive as litigation, it is hardly a sign of a really good relationship. Other than that what can you do? Some people like to provide for mandatory good faith bargaining before a lawsuit can be filed or arbitration is demanded. Again, this does not guarantee that the bargaining will lead to anything, but if there is a requirement that people sit down and talk to each other before they can demand arbitration, there is some tendency for that to lead to better results. In many situations it is common to have a neutral third party as part of the regular governance structure. For example, in strategic investments, the kind Steve Fraidin talked about this morning,[14] or in venture capital investments, it is common to have a board comprised of a couple of representatives from the investor; and a couple of representatives from the insiders, the managers; and neutral directors. Neutral directors can serve as tiebreakers, but their more important function is to act as facilitators. Neutral directors can encourage the two sides to be reasonable, to discuss things, and to be imaginative in trying to reach good results.

How does a lawyer maintain good relations? A lawyer can provide for regular contact between the parties. It is a good idea if the parties do this anyway, but there is no reason why a lawyer cannot put that in the contract. If relations in the alliance will not naturally be handled by the highest officers of the companies, provide for periodic consultation between the high officers of the companies. One reason for failure among alliances is a sense of the people involved in the alliance that the higher-ups aren't interested in it – i.e., that they don't have a commitment to the venture. A provision that the higher-ups will be involved and will consult with each other regularly means you are less likely to run into that problem.

I have already mentioned the importance of termination provisions, and one of the best guarantors of harmonious governance is that neither party sees any benefit in pulling out. Such provisions are important since a true joint venture is a partnership that under

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[13] Symposium, *The Role of Lawyers in Strategic Alliances*, 53 CASE W. RES. L. REV. 857 (2003).

[14] Fraidin & Lelutiu, *supra* note 5, at 870-71.

the Uniform Partnership Act may be dissolved by any partner at any time, thereby triggering an auction of partnership assets.[15] This opens up the possibility of opportunism; for instance, if one partner is unable to make a bid of the fair value of the assets, the other partner may be able to grab the assets of the venture at a bargain price.

To prevent such behavior, the lawyer must be aware of termination provisions. Such provisions can take many forms. For instance, if both parties are well-financed, you can have something like a Russian Roulette buy-out. That is, if a partner says it wants out, it must announce a value for the whole venture. The other side then has a choice. It can either buy out the partner who is terminating, or it can sell its interest to the partner who is terminating at the announced value. This is a variation on the classic way to divide a pie equally: have one person divide the pie, and then let the other person choose his piece. But, again, this works well only if the parties are well-financed. It does not work if one cannot afford to buy out the other. Of course the lawyer wants provisions that discourage opportunistic dissolution, but not necessarily all dissolution. You may have a situation, for example, in which one of the partners feels that the deal is unfair, that the other side is not cooperating and, yet, harsh termination provisions have that party locked into the deal and so that it cannot get out.

I said earlier that many business people and many lawyers think that lawyers often perform poorly in strategic alliances. How did we get into this mess, and how do we get out of it? The problem begins with law schools. Actually, it may begin before law school because in the media, in the movies, and on TV, the lawyer is always an aggressive adversary – i.e., a hired gun.

And what happens when students arrive at law school? Almost all first year courses are litigation oriented. And even to the extent that one encounters transactional courses in law school, there is still a tendency to be suspicious and say: "Watch out. The other side is probably trying to take advantage of you, so be careful. And, of course, bargain hard for your client, get the best possible deal you can." So, it is not surprising that when students emerge from law school and go into practice, they are bewildered by a client who says, "we are trying to cultivate a relationship of trust and confidence here, and everything you are doing is destroying that."

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[15] UNIF. P'SHIP. ACT § 31(1)(b) (1914), 6 U.L.A. 771 (1995).

What can law schools do about this? We should pay more attention to cooperative negotiation, including knowing when it is appropriate and when it is not. More generally, we should pay more attention to the transactional side of the law. We can also use a little help from the bar. Here at Case Western Reserve University we have created a set of concentrations that a student can choose, one of which is in business organizations. We are trying to get students to pay more attention to their curriculum. One difficulty we encounter is that students know that most employers don't care much about what courses students take. Generally, employers care about two things: (1) What law school did you go to?; and (2) What was your GPA? It's somewhat understandable that employers would have this attitude. Knowledge, employers can teach you; brainpower, they can't. And we use GPA as a proxy for brainpower. On the other hand, with clients becoming more demanding about billings and with firms becoming more reluctant to hire students who require a couple of years before they can do any useful work, maybe it makes sense now for employers to pay more attention to what students have taken in law school.

A last point, to be a little provocative: we hear constantly in academia these days that diversity is a strength. Well, one thing you learn in reading about trust, especially in sociology and economics, is that this is baloney. I believe people tend to trust others that are like themselves and to distrust those who are different from themselves. Diversity is an obstacle to trust that has to be overcome.

The problem in proclaiming that diversity is a strength is not just that it is false, but that it diverts us from what we ought to be doing. If we acknowledge that diversity is an obstacle, then we can talk about the many known ways of dealing with that obstacle. But, we can hardly address the problem if we refuse to acknowledge that diversity is an obstacle.