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The Silicon Valley Lawyer as Transaction Cost Engineer?

At a time when the legal profession is under assault from many quarters—blamed for America's lack of global competitiveness by the Quayle Commission, described in the popular press as a profession of sharks and shysters, and characterized by a leading academic as a profession "in danger of losing its soul"—Mark Suchman's sociological study of lawyers in the Silicon Valley presents an alternative view of the legal profession.

* Associate Professor, Georgetown University Law Center. I would like to thank Eric Posner, Chris Kimball, Richard Painter, Edward Bernstein, Daniel Klerman, Robert Merges, Maureen O'Rourke, David Dana, Amy Howe and Karen Fredericks.


2 See Marc Fischer, Life Without Lawyers? Defenders' Study Says We'll Miss Them. Don't Laugh, WASH. POST, July 8, 1994, at B1 (noting the existence of a 900 phone number, the "shark line, devoted entirely to lawyer jokes"); Michael Hill, May it Please the Court, Lawyers Just Want to Be Happy, L.A. TIMES, Sept. 18, 1994, at 11 (noting that lawyers are "often regarded as shysters and sharks").

3 ANTHONY T. KRONMAN, THE LOST LAWYER: FAILING IDEALS IN THE LEGAL PROFESSION 1 (1993) (mourning the demise of the lawyer-statesman, "possessed of great practical wisdom and exceptional persuasive powers, devoted to the public good but keenly aware of the limitations of human beings and their political arrangements").

profession. It describes a market, the market for venture capital financing of "new technology-based corporations," where lawyers are viewed favorably by their clients and are perceived of as adding value to a transaction rather than arguing over how to divide the transactional pie.

The study's detailed description of Silicon Valley legal practice is aimed at debunking the myths of the "lawyer as hired gun," suggesting instead that the lawyers play several different roles in Silicon Valley transactions, roles Suchman labels as "counseling," "dealmaking," "matchmaking," "gatekeeping," and "proselytizing," or, more generally, "conciliating."

This essay does not directly take issue with Suchman's conclusion that the image of the "lawyer as hired gun" does not accurately characterize the role of lawyers in the Silicon Valley. Indeed, the "hired gun" image is strikingly inappropriate in the transactional setting he focuses on in the most detail—high-technology venture capital financing. However, it suggests that the "hired gun" image is something of a straw man. The lawyer as

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5 This characterization is based on Hired Gun, supra note 4.
6 See id. at 1 (noting that Suchman's study casts doubt on the idea that lawyers have a "chilling effect ... on larger systems of economic activity ... [because] self-interested attorneys goad their clients into an excessively punctilious awareness of legal rights ... [which] in turn, drains the reservoir of trust and good faith that would otherwise lubricate the wheels of commerce").
7 On Advice, supra note 4, at 99 (explaining that in their counseling role, "attorneys see themselves as offering general business advice, rather than purely legal guidance").
8 Id. at 96 (suggesting that "when acting as dealmakers, Silicon Valley attorneys employ their connections in the local business community in order to link clients with various transactional partners").
9 Id. at 113 (explaining that the "organizational matchmaking role has three parts ... matchmakers ... winnow out 'ineligible' clients, who are so deviant either ethically or structurally that representing them would besmirch the matchmaker's reputation ... [they] formulate typologies of clients and encourage those who are seeking partners to certain culturally approved models ... [and they] apply cultural 'rules of compatibility' to their clienteles, arranging matches between 'likes' and discouraging contact between 'unlikes'").
10 Id. at 108 (explaining that "a 'gatekeeping' system seems to be emerging, in which law firms use their control over resource flows to screen out entities that challenge Silicon Valley's structural or behavioral taken-for-granted or that otherwise threaten community cohesion").
11 Id. at 109 (explaining that proselytizing "consists of counseling activity directed toward encouraging certain types of deals and discouraging others").
12 Conciliator, supra note 4.
“hired gun” may accurately characterize the role of business litigators—although in that context too the characterization is misleading in an era when most disputes are settled out of court and corporate use of alternative dispute resolution techniques is increasing dramatically. However, leaving litigators off to one side, the 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, in the Silicon Valley or elsewhere.

This essay suggests another characterization of the function of lawyers in the Silicon Valley, a characterization of the business lawyer first put forth by Ronald Gilson, the lawyer as a value creating transaction cost engineer. It briefly reexamines some of Suchman’s most salient findings about Silicon Valley legal practice from Gilson’s economic perspective, and argues that

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13 There is no direct measure of corporate use of ADR. However, over 600 large corporations and 1800 of their subsidiaries, including more than half of the Fortune 500 companies, have signed the Corporate Policy Statement on Alternatives to Litigation which provides, in part, that “[i]n the event of a business dispute between our corporation and another corporation which has made or will then make a similar statement, we are prepared to explore with that other party, resolution of the dispute through negotiation or ADR techniques before resorting to full scale litigation.” CPR LEGAL PROGRAM, CENTER FOR PUB. RESOURCES, CORPORATE POLICY STATEMENT: ALTERNATIVES TO LITIGATION (1991).

14 It is interesting to note that while Suchman suggests that Silicon Valley lawyers “reduce both conflict and uncertainty by seeing local capital markets not in an adversarial light, but as social structures with shared norms and well-established information flows,” Conciliator, supra note 4, at 9, he does not provide any reasons to think that such transactions would be concluded in an adversarial setting even in contexts where the strong elements of social cohesion he finds in Silicon Valley legal practice are absent. Indeed, in transactions where lawyers are often compensated under a “deferred billing structure,” where, “if a company doesn’t get funded . . . [the law firm will not] look to the founders, personally, to pay . . . [but if the] client . . . successfully locate[s] financing . . . [the] law firm’s premium fees [will immediately be paid] out of the newly-obtained capital reserves,” Hired Gun, supra note 4, at 12, it is particularly hard to understand why lawyers would want to engage in any of the types of “adversarial” or hired gun behaviors that might increase the risk that the company will be unable to secure financing.

15 See Ronald Gilson, Value Creation by Business Lawyers: Legal Skills and Asset Pricing, 94 YALE L.J. 239, 243 (1984); see also Lawrence M. Friedman et al., Law, Lawyers, and Legal Practice in Silicon Valley: A Preliminary Report, 64 IND. L.J. 555, 562 (1989) (noting that “[t]he Silicon Valley lawyer not only works with engineers, he thinks of himself as a kind of engineer—a legal engineer . . . his job is to solve problems, to take a principle, a task and engineer it legally”).

16 Suchman’s findings about the roles lawyers play in Silicon Valley transactions are based on “a series of roughly 25 semi-structured qualitative interviews . . . interviews [that] were divided approximately equally between lawyers, venture capitalists and entrepreneurs,” as well as “informal conversations with a handful of journalists,
when the roles and functions of Silicon Valley lawyers described by Suchman are analyzed in economic terms, it becomes clear that many of the roles that Suchman associates more closely with Silicon Valley lawyers than with the legal profession as a whole are, when viewed from Gilson’s perspective, performed by business lawyers, at least skilled business lawyers, in a wide variety of settings. It also suggests that even those roles and functions that appear to be either unique or unusually prominent in the Silicon Valley can nevertheless be understood as responses to many of the same types of underlying strategic considerations that Gilson discusses in his analysis of how the ordinary business lawyer creates value for his client.

Part I of this essay presents a brief overview of Gilson’s theory. Part II then summarizes some of Suchman’s findings and explores the ways that Gilson’s insights can be used to help Suchman more effectively debunk the myth of the “lawyer as transaction cost,” and the ways that Suchman’s findings might be used to provide support for Gilson’s suggestion that lawyers are value creating transaction cost engineers. Part III discusses how combining the theoretical and methodological approaches of law & economics and law & sociology can improve legal scholarship in general and Suchman’s study in particular. Finally, the essay concludes that analyzing Suchman’s findings from an explicitly economic perspective can yield insights into what it means to be a good transactional lawyer in the Silicon Valley or elsewhere.

I

Gilson’s Framework

In a 1984 article, Value Creation By Business Lawyers: Legal Skills and Asset Pricing,18 Ronald Gilson explores the question: how, if at all, do business lawyers add value to transactions apart from merely guiding clients through complex regulations or help-

academics, and other informal community watchers.” Hired Gun, supra note 4, at 2 n.3.

17 Contrary to Suchman’s suggestion in his comment, this essay does not claim to be “either more descriptively accurate or more aesthetically appealing than [his] original sociological rendition.” Translation Costs, supra note 4, at 257. Rather, it seeks to analyze the factual information Suchman presents in an effort to better understand why the legal profession is viewed in a more positive light in Silicon Valley than elsewhere and to better understand the ways, apart from drafting more complete contingent state contracts, that transactional lawyers might be able to create value for their clients.

18 Gilson, supra note 15.
ing them obtain a bigger share of the pie in a distributive bargains situation? In answering this question, Gilson begins by describing what is known in the finance literature as the Capital Asset Pricing Model.\textsuperscript{19} For the purposes of this essay it is not necessary to review the details of the model but only to note that because in the hypothetical world of the model "capital assets will be priced correctly as a result of market forces, business lawyers cannot increase the value of a transaction."\textsuperscript{20} As a consequence, absent the need to navigate complex government regulations, "the fees charged by business lawyers would decrease the net value of the transaction."\textsuperscript{21} In other words, in the world of the capital asset pricing model, lawyers or any other third party intermediaries would, by definition, be value decreasing transaction costs.

The Capital Asset Pricing Model is based on a number of simplifying assumptions\textsuperscript{22}—ways in which the world of the model diverges from the so-called real world—and it is these simplifying assumptions that are of primary relevance to our inquiry, namely, that: (1) information about the asset and about the relevant markets is costlessly available to all transactors; (2) there are no transaction costs; (3) buyers and sellers have homogeneous expectations, that is, similar views about the risk and return associated with the relevant asset(s); and (4) buyers and sellers have similar time horizons, that is, they are trying to maximize their returns over the same relevant time period.

Using these assumptions as his starting point, Gilson suggests that lawyers create value by bringing the real world of an individual transaction closer to the hypothetical world of the model and, in so doing, increase the size of the transactional pie.\textsuperscript{23} As Gilson

\textsuperscript{19} For an overview of the Capital Asset Pricing Model, see Richard A. Brearly and Stewart C. Meyers, Principles of Corporate Finance (4th ed. 1991), at ch. 8.

\textsuperscript{20} Gilson, supra note 15, at 251.

\textsuperscript{21} Id.

\textsuperscript{22} Both the Capital Asset Pricing Model and Gilson assume away another category of costs that characterize important ways that the real world of a particular transaction may diverge from the world of the model, namely legal system costs, those costs that arise from the fact that using the legal system to enforce a contract is costly and inherently uncertain. For a discussion introducing the idea of legal system costs and elaborating on how taking them into account might alter Gilson's analysis, see Edward A. Bernstein, Law & Economics and the Structure of Value Adding Contracts: A Contract Lawyer's View of the Law & Economics Literature, 74 Or. L. Rev. 189 (1995).

\textsuperscript{23} Gilson, supra note 15, at 300.
puts it, "when markets fall short of perfection," that is, when the model's assumptions do not perfectly describe the real world, which of course they never do, "incentives exist for private innovations that improve market performance. As long as the costs of innovation are less than the resulting gains, private innovation to reduce the extent of market failure creates value. It is in precisely this fashion that the opportunity exists for business lawyers to create value."  

The market for venture capital is, in many respects, characterized by extreme divergences from the world of the capital asset pricing model. As Suchman explains:

High-technology start-ups confront investors not only with high failure rates and dramatically variable returns, but also with large elements of sheer guesswork. Markets for new technologies are notoriously difficult to predict, since the performance of any given start-up may depend on technological developments that post date the firm's founding; since these technological developments themselves often depend on essentially random elements of timing and serendipity, they cannot be forecast even probabilistically. Further, high-technology investors may have difficulty identifying a relevant universe of technologies from which to construct a portfolio . . . . Equally formidable cognitive hurdles plague high-technology entrepreneurs . . . innovators often face the challenge of locating start-up funding in a time-sensitive environment where even small delays may (or may not) prove commercially disastrous . . . . [And,] founders are often hard-put to evaluate the fairness of those funding offers which they do receive.

Thus, (1) because information is often costly, unavailable or largely unverifiable; (2) because entrepreneurs and venture capitalists often have very different expectations about the risk and return associated with particular companies; (3) because the time horizons of venture capital funds and entrepreneurs may be different; and (4) because venture capital financing agreements are complicated and might require the parties to incur substantial transaction costs, it is not surprising that Silicon Valley lawyers are viewed favorably by their clients. The greater the divergence between the world of a transaction and the world of the capital asset pricing model, the more opportunities business lawyers are likely to have to create value for their clients.

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24 Id. at 253.
25 Id.
26 Conciliator, supra note 4, at 7.
II

THE SILICON VALLEY LAWYER AS TRANSACTION COST ENGINEER?

In order to understand how Silicon Valley lawyers might create value, it is useful to explore how, in the many legal and nonlegal roles they play, lawyers' activities might bring the real-world of a given transaction closer to the hypothetical-world of the capital asset pricing model. It is also interesting to take a step back and consider whether some of the less transaction specific roles played by these lawyers might be understood as "private innovations that improve market performance." According to Gilson, if lawyers really do create value, it should be possible to "find tracks of this activity in their transactional behavior." As a consequence, it is useful to look for such tracks by exploring the counseling, dealmaking, matchmaking, gatekeeping and proselytizing roles that Silicon Valley lawyers play in a typical venture capital financing transaction.

The Silicon Valley lawyer's role in a typical venture capital financing transaction begins when an entrepreneur approaches him with an idea for a company. The lawyer, in his capacity as a counselor, assists the entrepreneur in developing a business plan that identifies the information investors consider relevant and packages it in a form familiar to the venture capital funds. As one lawyer explained:

We're one of the forces that makes the fundraising market more efficient by saying, 'what you do is you have a business plan. You refine that to the point where it meets the standards and criteria that venture capitalists expect in business plans. It shouldn't be 800 pages long.' . . . Then you get that out and get feedback, and you'll [read] those tea leaves.

Once a business plan has been developed, the lawyer's role in the transaction changes from "counseling" to "matchmaking," "dealmaking," and "gatekeeping." In these capacities Silicon Valley lawyers play an essential role in transmitting information and bringing entrepreneurs and venture capital funds together.

27 Gilson, supra note 15, at 253.
28 Id. at 256.
29 The description of Silicon Valley legal practice presented in this essay is based solely on information presented in the sources cited in note 4, supra. Because the essay submitted by Suchman for publication in this symposium does not present an overview of his findings, it is necessary to do so here.
30 Conciliator, supra note 4, at 21.
Law firms control access to a substantial percentage of Silicon Valley's venture capital flow; one firm alone controls approximately forty percent to sixty percent of the capital available in the Valley. Funds acknowledge that lawyers are "an important part of the whole network of deal flow," entrepreneurs realize that it is essential to hire a law firm with an established reputation, and law firms explicitly recognize their matchmaking role in bringing entrepreneurs and venture capital funds together. As one lawyer explained, his firm has:

[A] committee that does this. When a partner has a new company that needs financing, we'll brainstorm just a little bit on who would be the best funds to send it to. Based on our knowledge of venture funds, and based on our knowledge of people in those funds, we can make introductions to people who we think would be good people to look at a particular proposal.

Lawyers' abilities to perform these matchmaking and dealmaking functions—and to do so in ways that minimize the joint pre-transaction search costs for the parties—depend on their position in the market as long term participants with established reputations as well as on their superior information about the business plans and prospects of potential start-up firms and the post-deal behavior of various funds.

A lawyer's investment in acquiring information about a potential start-up is less transaction specific than an equivalent investment made by a venture capital fund. If a law firm investigates a company and finds that it is not an appropriate investment for one fund, it might nevertheless be able to recommend it to another fund. In contrast, a venture capital fund that spent money to investigate a start-up but decided not to finance it would obtain no return on its investment. Similarly, while it would be pro-

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31 On Advice, supra note 4, at 96; see also id. at 99 (noting that as one venture capitalist explained, "the more senior lawyers have entrepreneurs that they are effectively representing on a no-fund retainer basis, and they get involved very early in these deals. The good lawyers have a lot of say over which funds see which entrepreneur. That's a very valuable role they play").

32 Id. at 97.

33 Conciliator, supra note 4, at 23-24.

34 Venture capital funds are concerned with being viewed favorably by law firms. As one fund partner explained, "we just did mailings to all the lawyers in Silicon Valley, making sure they knew who we were—so they wouldn't think we were some odd-ball firm in the hinterlands. Lawyers can act as a detriment if they don't know who you are and you don't have the relationships with them." On Advice, supra note 4, at 97.
hibitively expensive for each entrepreneur to inquire into the post-deal behavior of each fund to whom it submitted a business plan, it might be worthwhile for a law firm to obtain this type of information since it would be valuable to the firm in advising other clients in similar types of transactions.

Lawyers also play a role in verifying much of the initial information provided by the entrepreneur who is, in most cases, a new market entrant without an established reputation. After investigating the start-up's prospects, the lawyer, in effect, substitutes his reputation for the reputation of the entrepreneur. Because a law firm that encouraged a fund to investigate a company on the basis of inaccurate information would suffer reputational harm, funds are willing to rely on information provided by law firms to a much greater extent than information provided by entrepreneurs. When a lawyer solicits financing for a business plan, he is, in effect, providing the extra-legal equivalent of a lawyer's opinion letter in a typical corporate acquisition transaction, or, more specifically, a seller's opinion of counsel letter in the sale of a private company. Because the reputations of their clients are not effective bonding mechanisms, lawyers add value to the transaction by posting their own reputation as a bond. In some instances the posting of this type of bond enables transactions to take place that otherwise would not occur.

As a partner at Wilson, Sonsini, the most powerful law firm in the Silicon Valley

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35 As one venture capitalist explained, "[i]t doesn't make sense for a fledgling company to use a law firm that has never done anything in the venture area. It makes sense for them to focus on law firms that have a lot of contacts, that could assist them. It just adds a little more credibility." Id.

36 Firms are wary of representing clients who might tarnish the firm's reputation. As a Wilson, Sonsini partner explained, "the lawyer carries the ball for the client, in terms of opening up connections and introducing the client to the business world. We want to make sure that we're not making an introduction that will ultimately backfire on us." Hired Gun, supra note 4, at 19.

37 In some transactions, lawyers also post a more traditional monetary bond by agreeing to be compensated, at least in part, in the stock of the company. Id. at 12. The lawyer's willingness to accept this form of compensation sends a credible signal to the fund that the lawyer has faith in the company's prospects, and a credible signal to the entrepreneur that the lawyer thinks the fund will behave in a way that will lead to a successful venture.

38 For an interesting discussion about how lawyers who are able to establish a credible reputation for engaging in cooperative behavior might create value for their clients by, for example, enabling them to settle cases that might otherwise have gone to trial, see Ronald J. Gilson & Robert H. Mnookin, Disputing Through Agents: Cooperation and Conflict Between Lawyers in Litigation, 94 Colum. L. Rev. 509 (1994).
noted, "clients are coming through more and more on the basis of the firm's reputation and the perception that somehow we can enable transactions where transactions might not otherwise be possible."^39

In sum, because their structural position in the market enables them to back their representations with a meaningful reputation bond, lawyers can function as cost efficient brokers who create value by increasing the amount and reliability of the operational and reputational information available to transactors while greatly reducing the pre-transaction search costs associated with venture capital financing transactions.

In the process of bringing entrepreneurs and funds together, lawyers also perform what Suchman terms a gatekeeping function in which they "accept and refer clients selectively . . . screen[ing] out entities that challenge Silicon Valley's structural or behavioral taken-for-granteds or that threaten community cohesion."^40 By screening out transactors who are unwilling to abide by established transactional and behavioral norms, lawyers increase the likelihood that "parties to a transaction will share a common framework of basic values and assumptions . . . [that will] moderate[] the uncertainty of anonymous market relations."^41 They may therefore create value by bringing the expectations of both the parties to a particular transaction and potential transactors in the market as a whole closer to the homogeneous expectations assumption of the capital asset pricing model.

After bringing the entrepreneur and the fund together, the lawyer resumes his role as counselor and assists the parties in selecting an appropriate transactional form. Most Silicon Valley lawyers encourage the parties to use one of several standard form venture capital financing agreements. As one senior lawyer explained, lawyers "have three cookie cutters and they just ask: 'Is it A, B, or C?' They are going to force these things into one of those cookie cutters."^42 Accepting, for the purposes of discussion,^43 Suchman's assertion that "contrary to the tenor of much

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^39 Conciliator, supra note 4, at 16.
^40 On Advice, supra note 4, at 108.
^41 Hired Gun, supra note 4, at 19-20.
^42 Id. at 23.
^43 For the purposes of discussion this essay accepts Suchman's assertion that each of the standard form financing agreements in widespread use "represents a logically defensible vision of the venture capital relationship—a coherent facially-neutral im-
of the trade literature," none of these standard form agreements are "unequivocally 'pro-company' or 'pro-investor,'" it is possible to identify several ways in which the use of standard form agreements might create value. First, the use of standard form contracts might decrease pre-transaction negotiation costs. As one lawyer observed, when "there's a transaction with one of the other Silicon Valley law firms, there's very little argument or negotiation about the agreement. It just goes smoothly. The transaction costs tend to be minimal," while another lawyer noted, "[w]hen I deal with lawyers in other parts of the country, they... will go crazy over a lot of stuff that would just draw a yawn from a Silicon Valley law firm." Because the post-deal relationship between the entrepreneur and the fund is like a partnership, contentious or prolonged pre-transaction negotiations that erode

age upon whose merits well intentioned community members might honorably disagree." On Advice, supra note 4, at 303. This claim, however, cannot be verified empirically since Suchman does not provide examples of these agreements. In addition, on the basis of theory alone there are reasons to doubt whether these forms are evenhanded, particularly in transactions where one lawyer sometimes represents both the entrepreneur and the fund. Unlike the entrepreneurs who are, for the most part, unsophisticated one-time players in the market for initial venture capital financing, see Hired Gun, supra note 4, at 7 (noting that "a lot of people that start companies have spent their careers as engineers—or, even less sophisticated, in academia...[and] someone who has never [set up a company]...generally ha[s] no clue what's going on"), the funds are repeat players who, if satisfied by a particular lawyer's services, would be likely to give the lawyer business in the future. As a consequence, lawyers may have a strong financial incentive to draft contractual provisions that favor the funds at the expense of the entrepreneurs. Given this incentive, it might be that lawyers are not creating value, but are simply transferring value from entrepreneurs to funds. Alternatively, they may be enlarging the transactional pie but distributing most of the gains to the funds. However, Suchman's failure to collect separate information about transactions where each party was represented by its own lawyer and transactions where one lawyer represented both sides, as well as his failure both to describe the standard forms and to investigate whether certain forms were used more or less frequently in single-lawyer transactions, makes it impossible to determine which of these characterizations of the lawyers' counseling role in drafting and urging parties to use standard form financing agreements is most accurate.

44 On Advice, supra note 4, at 303. In reaching the conclusion that these forms are, for the most part, evenhanded, Suchman fails to recognize that it is impossible to determine whether an agreement is pro-company or pro-investor without also looking at the transaction price since there is always a trade-off between price and other contractual provisions.

45 Id. at 106.

46 Hired Gun, supra note 4, at 22.

47 As one venture capitalist put it, "we try to establish a true partnership with the founders of companies, where we are very much on the same side of the fence in terms of how the deal is structured." Conciliator, supra note 4, at 19 n.2.
trust and goodwill may impose particularly high costs on the parties. As a consequence, reducing these costs has the potential to create value. Second, reducing these types of "attitudinal" negotiating costs may also reduce the likelihood of transaction breakdown which may be especially valuable to the entrepreneurs, since in these transactions "even small delays [in locating financing] may... prove commercially disastrous." Finally, by confronting transactors with an acceptable way of concluding the transaction, these standard form agreements may induce some parties who are either unfamiliar with, or do not intend to abide by, the Valley's largely informal transactional norms to reveal their identity since such parties are more likely than others to seek to alter the standard form agreements to include additional terms and protections.

Thus, the use of standard contractual forms may create value by reducing transaction and negotiating costs, reducing the likelihood of transaction breakdown, and, perhaps, increasing the amount of information about particular parties' willingness to abide by community norms. In addition, over time, the use of standard form agreements may, as Suchman suggests, play an important role in lawyers' attempts to "construct... the normative rules and the cognitive typifications... that make such transactions comprehensible, desirable, feasible and meaningful," at-

48 Lawyers also reduce these types of negotiating costs in their role as proselytizers, see infra text accompanying notes 54-57, because "tutored in community norms [by their lawyers], contracting parties know which demands are (or are not) legitimate and 'reasonable'—which concessions others may expect of them, and which concessions they may expect in return." Hired Gun, supra note 4, at 10.

49 For a discussion of the often ignored importance of attitudinal negotiation costs in commercial transactions, see Edward Bernstein, supra note 22, at 229-32.

50 In many transactions, lawyers too will have an interest in reducing the likelihood of transaction breakdown since they bear most pre-transaction search costs and are sometimes paid only if the deal goes through. In addition, because matching a fund with a particularly contentious entrepreneur, or matching an entrepreneur with a particularly contentious fund, might damage a lawyer's reputation as a matchmaker and dealmaker, lawyers have an incentive to ensure that negotiations proceed smoothly.

51 Hired Gun, supra note 4, at 7.


53 Translation Costs, supra note 4, at 264.
tempts that may facilitate the evolution of more nearly homogeneous expectations in the market as a whole.

The formulation of homogeneous expectations is further reinforced by the lawyer's role as a proselytizer. According to Suchman, proselytizing involves "foster[ing] and reinforc[ing] community norms by promoting certain types of financing transactions over others," and providing "counseling about the range of 'reasonable' terms and valuations, [and] subtly steering clients towards negotiating positions that comport with the prevailing community practices." As one lawyer explained, "the markets for these deals are very inefficient and people don't have a good idea of what kind of payments are involved so as a lawyer who sees lots of these deals, we're sort of an information repository about how these deals get done." Thus, the lawyer-proselytizer, by "serv[ing] as a crucial repository for information about the range of reasonable terms and valuations," is promoting, both within the individual transaction and the community as a whole, more nearly homogeneous expectations about the risk and return associated with different types of transactions.

In sum, because lawyers' roles as counselors, dealmakers, matchmakers, gatekeepers and proselytizers are "explainable by their relation to one or more of the perfect market assumptions on which capital asset pricing theory is based," they might be interpreted as "tracks" of Silicon Valley lawyers' value creating activities in both individual venture capital financing transactions and the market for venture capital as a whole.

III
IMPLICATIONS FOR THE LEGAL PROFESSION

In discussing the implications of his theory of the business lawyer as transaction cost engineer, Gilson suggests that it is important to understand the ways that lawyers create value since once

54 Hired Gun, supra note 4, at 20.
55 On Advice, supra note 4, at 111.
56 Id.
57 This point is implicitly recognized by Suchman when he explains that the lawyer-proselytizer, by "creat[ing], transmit[ting], sustain[ing] and enforc[ing] a normative and cognitive order that increases the stability and predictability of the local capital market," Hired Gun, supra note 4, at 18, plays an important role in "facilitat[ing] smoothly-functioning capital markets by socializing the entrepreneur in the conventions of the local investor community." Id. at 21.
58 Gilson, supra note 15, at 256.
the mechanisms by which they do so are identified it becomes immediately apparent that other market participants, such as investment bankers, could easily become skilled transaction cost engineers. This leads him to conclude that unless lawyers also acquire and perfect the skills needed to create value in this way, much of the legal profession's business may, in the future, be competed away. He suggests, however, that if lawyers develop a "self-conscious understanding of the function they really perform,"\textsuperscript{59} they will be more likely to "[c]ompet[e] successfully for the role of transaction cost engineer."\textsuperscript{60} Suchman's work suggests that lawyers in the Silicon Valley have just such a clear understanding of their function. Silicon Valley lawyers explicitly recognize the importance of the many traditionally non-legal roles they play. For example, one lawyer observed, "business lawyers . . . tend to be counselors in the broader sense. . . . Larry Sonsini . . . he's gone beyond just being a lawyer into being something of a business advisor,"\textsuperscript{61} while another noted, "[t]here's a lot of nonlegal advising that goes on,"\textsuperscript{62} and a senior partner explained, "good lawyers in this practice have to provide more than simply legal advice. They are a wonderful resource for business advice . . . the business lawyer is a repository of experience."\textsuperscript{63} Whether this self-conscious recognition of the functions they perform will in fact enable lawyers to retain their privileged position in the Silicon Valley remains to be seen. The next few years should, however, provide an interesting test for Gilson's hypothesis that if lawyers understand the ways they create value they will be better able to compete for business.

\textsuperscript{59} Id. at 302. Although in his comment on this essay Suchman suggests that Silicon Valley "[l]awyers generally disavow technical or financial expertise," \textit{Translation Costs}, supra note 4, at 263, his dissertation contains extensive evidence that Silicon Valley lawyers view themselves, and are viewed by their clients, as being business advisors as well as legal advisors. \textit{See generally On Advice}, supra note 4, at ch. 5; \textit{see also infra} text accompanying notes 61-63. He also provides evidence that clients, even the more sophisticated venture capitalists, are willing to acknowledge that lawyers often give solid business advice. As one venture capitalist put it, "the legal people get involved in giving nonlegal advice also . . . oh yeah. They [the lawyers] see enough of the business issues and most of them are not shy about checking in and saying, 'look at this.' I think that's probably a positive. You want them to have their head in the game, in terms of understanding some of these business issues." \textit{On Advice}, supra note 4, at 102.

\textsuperscript{60} Gilson, supra note 15, at 302.

\textsuperscript{61} On Advice, supra note 4, at 95.

\textsuperscript{62} Id. at 100.

\textsuperscript{63} Id. at 101.
At this juncture, it is important to note that while this essay has tried to identify ways that Silicon Valley lawyers might create value for their clients, the extent to which they actually do so cannot be determined from Suchman's study. As Suchman himself recognizes, his findings are also consistent with the hypothesis that "lawyers earn their pay primarily as touts and bouncers for the prevailing legal regime," a regime that might increase the Silicon Valley legal profession's profits by, for example, creating socially constructed barriers to entry that prevent lawyers from other parts of the country from effectively competing for Silicon Valley business. In order to determine whether value creation or a desire to obtain and retain market power can better account for the many roles played by Silicon Valley lawyers, it would be necessary to, among other things, subject the dominant forms of the venture capital financing agreement to the type of clause-by-clause analysis Gilson applies to the corporate acquisition agreement, something Suchman fails to do. It would also be desirable to wait until a particular set of contractual archetypes had remained stable over a significant period of time before undertaking this type of analysis. It is, however, important to note that because unlike the typical corporate acquisition agreement analyzed by Gilson, which deals with a one-time transaction, a venture capital financing agreement creates a long-term relational contract between the parties, many of the most important terms of this contract may be implicit in the parties' relations and understandings rather than explicitly dealt with through detailed contractual provisions. As a consequence, any attempt to determine whether Silicon Valley lawyers actually create value for their clients would have to look not only at the terms of the parties' written agreements, but also in great detail at the social and organizational environment in which these transactions are concluded.

In his comment on this essay Suchman characterizes the application of economic analysis to sociological data as an act of

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64 Translation Costs, supra note 4, at 267.
65 Given their control over Silicon Valley's capital flow, see supra text accompanying notes 31-33, and their active role in creating and transmitting constitutive information, including "cultural norms, definitions and scripts that construct both decision makers and decisions—chartering certain entities as purpose-bearing actors; imbuing those entities with particular tastes, values and objectives; and establishing for those entities menus of strategic options and typologies of situational considerations," Translation Costs, supra note 4, at 262 n.12, it is possible that Silicon Valley lawyers are able to exercise a great deal of market power.
“translation,” a characterization that stems, at least in part, from his view that the disciplines of economics and sociology are in some respects antagonistic and that each is directed at “highlighting certain features of the social world, while downplaying others.” This essay, however, has sought to take a different approach, one that views economics and sociology as compatible and complementary disciplines. This perspective suggests that economics can assist sociologists in designing their studies as well as in identifying common patterns across sociological data sets, and that taking sociological considerations into account can help economists demonstrate the predictive and explanatory power of some models in the law and economics literature as well as economic analysis more generally.

Suchman is, however, correct that the blend of law & economics and law & sociology attempted in this essay is largely an act of

66 Translation Costs, supra note 4, at 259.

67 The tensions between economics and sociology that Suchman identifies in his comments on this essay, see id. at 259-60, are based almost exclusively on a view of economics as pure neo-classical economics, a view that ignores the emerging economic literature on the evolution of norms and the theory of repeat play games, literatures that have given economists the tools necessary to model increasingly complex social interactions. For an overview of the application of game theoretic approaches to legal topics, see BAIRD ET AL., GAME THEORY AND THE LAW (1994).

68 See, e.g., ROBERT ELLICKSON, ORDER WITHOUT LAW: HOW NEIGHBORS SETTLE DISPUTES 167 (1991) (using evidence from a number of case studies to support the hypothesis that “members of a close-knit group develop and maintain norms whose content serves to maximize the aggregate welfare that members obtain in their work-a-day affairs with one another”); Lisa Bernstein, Social Norms and Default Rules Analysis, 3 S. CAL. INTERDISC. L.J. 59 (1994) (discussing how taking social norms and other relational factors into account enriches rather than under-mines the analysis and predictions of various approaches, including the economic approach, to default rules analysis); Lisa Bernstein, Opting Out of the Legal System: Extralegal Contractual Relations in the Diamond Industry, 21 J. LEGAL STUD. 115 (1992) [hereinafter Opting Out] (discussing the importance of taking social norms and sanctions into account in assessing the efficiency of any transactional rule or measure of damages); Robert Cooter, Structural Efficiency and the New Law Merchant, 14 INT’L REV. OF LAW & ECON. 307 (1994) (suggesting that rather than attempting to evaluate the “efficiency” properties of a norm according to objective criteria, the courts should look to the structure of the situation in which the norm was generated to see if the situation is of a type that would be likely to give rise to efficient norms); Janet T. Landa, A Theory of the Ethnically Homogeneous Middleman Group: An Institutional Alternative to Contract Law, 10 J. LEGAL STUD. 349 (1981) (developing a “theory of the ethnically homogeneous middleman group,” and using it to better understand the trading patterns of Chinese middlemen); Eric Posner, The Regulation of Groups: The Influence of Legal and Nonlegal Sanctions on Collective Action, (forthcoming in the University of Chicago Law Review) (arguing that the existence of solidary groups with their own norms must be taken into account when trying to predict the effect of certain legal rules on behavior).
translation, and as such can make only a limited substantive contribution to the literature. However, even if the contribution that economic analysis can make to sociology may be limited, though not nearly so limited as Suchman suggests, when economics is brought in at the end stage of a study when the issues to be explored have been defined and the data have been collected, this does not mean that its contribution will be similarly limited when economics is used to inform the design and execution of sociological studies.

In sum, analyzing the findings of Suchman's study in terms of Gilson's value creation framework can help teach business lawyers an important lesson, namely that in many contexts state contingent contracting is only one of a variety of ways of dealing with the risk of various different types of opportunism that might arise in contractual relationships. Although the alternative, extralegal, ways of constraining opportunism will differ depending on the social and transactional context in which a deal is concluded,\(^6\) failure to consider the existence of extralegal and social norm-based constraints on behavior\(^7\) may lead lawyers to "the crime of which lawyers are constantly accused and are often guilty—overlawyering."\(^7\)

\(^6\) See Gilson, supra note 15, at 312 (noting that "while the potential for opportunism may be universal, the efficiency of a particular solution in large measure may be accidentally and historically determined").

\(^7\) It is, however, also important to note that in many contexts it may be more expensive to resort to extralegal constraints on behavior than it is to draft a host of detailed contractual provisions. See Opting Out, supra note 68, at 132 (suggesting that in some contexts "[i]t is not clear a priori that th[e] costs [of drafting detailed contractual provisions] are necessarily higher than those incurred in the formation of an extralegal contract consummated with a handshake").

\(^7\) Edward Bernstein, supra note 22, at 191.