

Using Proactive Law for Competitive Advantage

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INTRODUCTION

In recent years, legal scholars in the United States and Europe have explored aspects of legal strategy relating to competitive advantage and the role of law as a positive force within companies. In the United States, the focus has been on law as a source of competitive advantage, while in Europe an approach known as Proactive Law has emerged. This article represents the first attempt to trace the history of these parallel developments and to merge their common themes. In applying concepts from these movements to the contracting process, the article demonstrates their potential to fundamentally change the way management perceives and uses the law. The contracting example also illustrates the opportunities that contracts and the law offer to create new value and innovate in areas often neglected by managers.

Part I of the article provides a holistic overview of research by U.S. legal scholars that ranges from an examination of theoretical links between law and competitive advantage to a specific action plan that encourages firms to make better use of their legal resources. Part II examines the Proactive Law Movement and the recognition that it has received in the public policy arena. Part III provides an analysis of the intersection between these developments in the U.S. and Europe, using contract law and the contracting process for illustrative purposes. The article concludes in Part IV by emphasizing how concepts relating to the use of law as a source of competitive advantage can lead to economic success in a manner that also promotes high ethical standards.

I. LAW AS A SOURCE OF COMPETITIVE ADVANTAGE: THE UNITED STATES PERSPECTIVE

Legal scholars in the United States began to seriously consider law as a source of competitive advantage during the first decade of the twenty-first century. Not surprisingly, professors teaching courses on business law in business schools were the leaders in this emerging field.¹ This Part of the article provides a holistic overview of the field by examining research by these scholars relating to a number of questions. Part I.A. asks whether law is a viable source of sustainable competitive advantage. Part I.B. describes prior attempts to link business strategy

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¹ See Robert C. Bird, *Law, Strategy and Competitive Advantage* 5 (Working Paper Series 2009), available at <http://ssrn.com/abstract=1327795> (last visited Feb. 11, 2010) [hereinafter Bird, *Competitive Advantage*]. See also Robert C. Bird, *Pathways of Legal Strategy*, 14 STAN. J.L. BUS. & FIN. 1, 4 n.19 (2008) [hereinafter Bird, *Pathways*] (“Authors such as Constance Bagley (Harvard, now Yale), George Siedel (Michigan), and James Holloway (East Carolina) have all researched the law-strategy question with some success. All three have served primarily as teachers of law in their respective business schools.”).

and legal strategy. Part I.C. explores whether variables exist within firms that encourage the development of law as a source of competitive advantage. Part I.D. examines the public policy objectives of the law that managers should understand in seeking competitive advantage. Part I.E. discusses legal strategy approaches currently used by firms. Part I.F. presents a potential plan that enables managers to convert competitive advantage frameworks and concepts into action. We now turn to research relating to the first question.

A. The Concept of Sustainable Competitive Advantage and its Relationship to Law

As the words imply, competitive advantage is something that gives a firm an *advantage* over *competitors*. In his classic work *Competitive Advantage*, Harvard Business School Professor Michael Porter explains that competitive advantage arises when firms offer their customers value that exceeds value offered by their competitors and operate in a profitable manner by charging customers more than the cost of value creation.² Firms can achieve the first element by “offering lower prices than competitors for equivalent benefits or providing unique benefits that more than offset a higher price.”³

Viewed from another perspective, “[a] competitive advantage is a strategy that creates value that is not already being implemented by any current or potential competitors and cannot easily be imitated in the short term.”⁴ But competitive advantage alone, while necessary for business success, is not sufficient. The competitive advantage must also be sustainable so that rivals are unable to adopt the same strategy. In an especially thoughtful and in-depth analysis, Robert Bird of the University of Connecticut concludes that law “can be a source of sustainable competitive advantage.”⁵

In reaching this conclusion, Bird asks four questions that are based on Ohio State University Professor Jay Barney’s framework for analyzing resource attributes that are necessary if firms are to achieve sustainable competitive advantage.⁶ First, does the resource possess value—for example, does the resource allow the firm to act more effectively and efficiently?⁷ Second, is the resource rare in the sense of being unavailable to some or all competitors?⁸ Third, is the resource “imperfectly imitable” because, for example, of “unique historical conditions?”⁹ Finally, is there a “lack of equivalent substitutes”—an inability of competitors to copy a firm’s resources?¹⁰

In applying these questions to the law, Bird concludes that:

² GEORGE J. SIEDEL, USING THE LAW FOR COMPETITIVE ADVANTAGE 5 (2002) (citing MICHAEL PORTER, COMPETITIVE ADVANTAGE 3 (1985)).

³ *Id.* (quoting PORTER, *supra* note 2, at 3).

⁴ Bird, *Pathways*, *supra* note 1, at 25 (citing Jay Barney, *Firm Resources and Sustained Competitive Advantage*, 17 J. MGMT. 99, 102 (1991)).

⁵ Bird, *Competitive Advantage*, *supra* note 1, at 26.

⁶ *Id.* at 7. An article in this special issue also addresses several of these elements. Constance E. Bagley, *What’s Law Got to Do with It: Integrating Law and Strategy*, 47 AM. BUS. L.J. ___ (2010).

⁷ Bird, *Competitive Advantage*, *supra* note 1, at 8 (citing Barney, *supra* note 4, at 106).

⁸ *Id.* at 8-9 (citing Barney, *supra* note 4, at 106-07).

⁹ *Id.* at 9-10.

¹⁰ *Id.* at 12 (citing Barney, *supra* note 4, at 106).

Laws confer significant *value* to firms through the protection of innovation, the enabling of free labor markets, and the efficient regulation of contracts. Some legal resources are also *rare*, such as the benefits conferred through individual contracts between buyers and suppliers, manufacturers and customers, and labor and management. The competitive advantage of legal resources may be sustained by virtue of *their imperfect imitability*, their causal ambiguity, and their social complexity. Finally, *substitutes for laws* are rare and costly to obtain.¹¹

If law is a source of competitive advantage, as Bird concludes, then how have firms attempted to link business strategy with legal strategy in the past? We now turn to this question.

B. Historical Attempts to Link Business Strategy and Legal Strategy

Historically, legal strategy was to a large extent divorced from business strategy and focused mainly on litigation strategy and risk management. For example, a firm might adopt a legal strategy that favors settlement of cases over prolonged litigation in recognition of the fact that litigation costs are high. Or a firm's strategy might be to litigate all cases to the end, regardless of cost, to send a signal to potential plaintiffs. In the words of Columbia Law School Professor John Coffee, settlement is "like putting out warm milk for a stray cat that meows. . . . You get 30 more cats the next night. This will create an incentive for others to" seek a legal remedy.¹²

There are two areas, however, where there has been some intersection of legal strategy and business strategy. First, a firm could decide to invest resources in law reform to align public policy with the firm's objectives. Professor Richard Shell of Wharton provides a classic example in his book *Make the Rules or Your Rivals Will*. When the Walt Disney Company faced the loss of copyright protection on characters such as Mickey Mouse, the company "persuaded Congress to add twenty years to the length of time that every creative work in the United States enjoys monopoly protection."¹³

However, investment in law reform is a two-edged sword because in many cases the law reform will benefit all companies in the industry, eliminating an opportunity for competitive advantage. Worse yet, by depleting its own resources in an effort to change public policy a firm might create a competitive disadvantage compared to free riders who benefit from the law reform. In the words of Northwestern Professor Leigh Thompson, "[t]hose who fail to contribute are known as defectors or free riders. Those who pay while others free ride are affectionately known as suckers."¹⁴

The second area where legal strategy and business strategy have intersected to some extent relates to decisions regarding the location of business activities. Historically, certain countries provided a *comparative* advantage in the form of lower legal costs. For example, in the

¹¹ *Id.* at 26 (emphasis added).

¹² Charles Gasparino, *Merrill Is Paying in Wake of Analysts' Call on Tech Stock*, WALL ST. J., July 20, 2001, at C1.

¹³ G. RICHARD SHELL, *MAKE THE RULES OR YOUR RIVALS WILL* 3 (2004).

¹⁴ LEIGH THOMPSON, *THE MIND AND HEART OF THE NEGOTIATOR* 227 (1998).

past certain firms might have been attracted to China because of lower production costs in part attributable to labor and environmental laws.¹⁵

The attractiveness of this form of legal strategy has lessened in recent years for two reasons. First, in our global economy with its cross-border migration of goods, services, labor, and investments, legal costs have also become globalized. For example, goods produced in one country might result in liability and regulatory concerns in another country where they are sold and used. In one case, members of the band Judas Priest were sued in Nevada on a claim that one of their albums caused suicidal reactions from listeners.¹⁶ The court decided that the Nevada court had jurisdiction over the band members, who were residents of the United Kingdom, because “the band members consciously and deliberately chose to develop a world-wide market.”¹⁷ The ever-increasing number of companies that manufacture goods in one country and then choose “to develop a world-wide market” face similar liability risks.

The second reason why legal comparative advantage has diminished in recent years is that laws have migrated across borders, creating convergence of both substantive and procedural law. There are numerous examples of the convergence of substantive law.

- Contract Law: The Convention on Contracts for the International Sale of Goods, originally approved at a 1980 conference in Vienna, has been adopted by seventy-four countries, including the United States.¹⁸
- Product Liability: Strict liability theory as applied to product liability originally developed in the United States. A 1985 European Economic Community product liability directive that is based on strict liability has spread throughout the European Union and on to the Pacific Rim.¹⁹
- Environmental Law: The “polluter pays” principle, whereby polluters are responsible for remedying the waste they generate, has been adopted by regulators in the United States, Europe and Asia.²⁰
- Securities Regulation: Other countries have adopted U.S.-style insider trading laws²¹ and there are indications that these laws will be enforced through harsh penalties.²²

¹⁵ See, for example, ALEXANDRA HARNEY, *THE CHINA PRICE: THE TRUE COST OF CHINESE COMPETITIVE ADVANTAGE* (2008) for a critical analysis of these two sources of China’s labor and environmental laws.

¹⁶ *Judas Priest v. Second Judicial Dist. Court*, 760 P.2d 137 (Nev. 1988).

¹⁷ *Id.* at 139.

¹⁸ CISG: Table of Contracting States, <http://www.cisg.law.pace.edu/cisg/countries/cntries.html> (last visited July 9, 2010). See also George J. Siedel, *Six Forces and the Legal Environment of Business: The Relative Value of Business Law Among Business School Core Courses*, 37 AM. BUS. L.J. 717, 733 n.42 (2000).

¹⁹ Australia, China, Japan, and Taiwan are among the Pacific Rim countries that have enacted product liability legislation. George Menzies, *Variations in Damages*, INT’L. BUS. LAW., Feb. 1998, at 75.

²⁰ Eric Thomas Larson, *Why Environmental Liability Regimes in the United States, the European Community, and Japan Have Grown Synonymous with the Polluter Pays Principle*, 38 VAND. J. TRANSNAT’L L. 541 (2005). See also James O. Pagliaro & Brody L. Green, *E.C. Directive: Proposal is Based on CERCLA*, NAT’L L.J., Feb. 10, 1992, at 27.

²¹ See, e.g., Richard S. Biegen et al., *Countries Strengthen Insider Trading Laws*, NAT’L L.J., Nov. 13, 1995, at C19.

²² See, e.g., China: Former President of Guangfa Securities Sentenced to Four Years in Prison for Insider Trading, Securities Docket (Jan. 11, 2009), <http://www.securitiesdocket.com/2009/01/11/china-former-president-of-guangfa-securities-sentenced-to-four-years-in-prison-for-insider-trading/>.

- Sexual Harassment: The definition of sexual harassment established by the United States Supreme Court in *Meritor v. Vinson*²³ has become an international standard.²⁴

Procedural law has also been subject to convergence as many features of the U.S. system have been diminished or exported to other countries. For example, countries in Europe and Asia have adopted the use of contingency fees²⁵ and class actions,²⁶ while in the United States punitive damages have been limited by state laws²⁷ and jury trials have become uncommon.²⁸ As noted by the chair of the American Bar Association Litigation Section, “[f]or the first time in our country’s history, the future of the jury system is in serious jeopardy.”²⁹

The net effect of this convergence of substantive and procedural law is that a firm’s ability to merge legal and business strategy on the basis of a country’s comparative advantage has diminished. For example, after China upgraded its environmental laws, a major United States company closed its plant in Jiangsu Province. The company concluded that its operations were no longer profitable because of the new regulations.³⁰

C. Variables within Firms that Encourage the Development of Law as a Source of Competitive Advantage

Changes in the legal environment should create incentives for firms to search for new forms of competitive advantage. However, managers often think of law as a burden or obstacle rather than a source of competitive advantage. On the one hand, this benefits firms that understand the importance of legal strategy because their use of the law will be difficult to copy.³¹ But on the other hand, managerial attitudes create a challenge for firms that decide to use the law for competitive advantage. These firms need to pay especially close attention to the variables within the firm that encourage the development of legal strategy.

Robert Bird has identified two types of variables that relate to the development of legal strategy: attitudinal variables and attributive variables.³² He defines attitudinal variables as “viewpoints that are embodied by individuals that may impact a person’s decisions, interests, values, or behaviors.”³³ Attributive variables are the characteristics “of an organization or of the

²³ *Meritor Sav. Bank v. Vinson*, 477 U.S. 57 (1986).

²⁴ Lynn Sharp Paine & Lara Adamsons, *Note on the Law of Sexual Harassment 5-7* (Harvard Business School Case Study No. 9-308-096, Aug. 1, 2008).

²⁵ Siedel, *supra* note 18, at 735 n.50.

²⁶ Colin Loveday, *Multi-Party Rules: US, Canada, Australia and the UK*, INT’L BUS. LAW., Feb. 1998, at 77.

²⁷ *See, e.g.,* Martha Middleton, *A Changing Landscape: As Congress Struggles to Rewrite the Nation’s Tort Laws, the States May Have Already Done the Job*, A.B.A. J., Aug. 1995, at 56.

²⁸ *See, e.g.,* William G. Young, *Vanishing Trials, Vanishing Juries, Vanishing Constitution*, 40 SUFFOLK U. L. REV. 67 (2006).

²⁹ Mark Curriden, *Putting the Squeeze on Juries*, A.B.A. J., Aug. 2000, at 52, 53.

³⁰ Jingzhou Tao, *Environmental Liability of Foreign Invested Enterprises in the People’s Republic of China*, INT’L BUS. LAW., July-Aug. 2000, at 314.

³¹ Bird, *Competitive Advantage*, *supra* note 1, at 14.

³² *Id.* An article in this special issue analyzes elements of both of these variables. David Orozco, *Legal Knowledge as a Managerial Resource*, 47 AM. BUS. L.J. __ (2010).

³³ Bird, *Competitive Advantage*, *supra* note 1, at 14.

people employed by it.”³⁴ Examples of attributive variables include use of in-house counsel, a firm’s use of non-lawyers in dealing with legal problems, and the degree of regulation that the firm faces.³⁵

Bird’s analysis of both attitudinal and attributive variables is especially useful because it establishes an agenda for future research on the law and competitive advantage. For example, he concludes that “Little research exists on manager attitudes towards business law.”³⁶ Future research could build on past studies. One of these studies, which is based on feedback from hundreds of senior managers, concludes that learning about the law is of great value to them, ranking above all other business school disciplines except for organizational behavior/human resource management and finance.³⁷ There also have been numerous studies of topic preferences of managers.³⁸

D. Public Policy Objectives of the Law

Once the attitudinal and attributive variables are in place to encourage the development of legal strategy and the use of law for competitive advantage, managers need a framework for understanding the public policy objectives of the law. Professor Constance Bagley of Yale has developed an outstanding framework that illustrates how the objectives of the law increase a firm’s chances for success.³⁹ She divides the objectives into four categories.

First, the law is designed to promote economic growth. As Bagley explains, the law promotes growth by “protecting private property rights[;] enforcing private agreements; facilitating the raising of capital; allocating risks; creating incentives to innovate; promoting liquid and skilled labor markets; providing subsidies, tax incentives, and infrastructure; and promoting free trade in the global markets.”⁴⁰ Bagley provides useful examples within each of these areas. For example, in allocating risks, managers should understand product liability law, environmental regulation, respondeat superior, and unconscionability.⁴¹

The second category of public policy objectives relates to worker protection, which “is accomplished by regulating certain terms and conditions of employment, requiring the employer to provide certain benefits, and protecting workers’ civil rights.”⁴² Examples of employee benefits include workers’ compensation, unemployment insurance, and social security.⁴³

³⁴ *Id.* at 21-22.

³⁵ *Id.* at 23-25.

³⁶ *Id.* at 15.

³⁷ Siedel, *supra* note 18, at 727.

³⁸ See Michael W. Little & William H. Daughtrey, Jr., *Survey of Virginia Corporate Executives on the Role of Law in Business Curricula*, 13 J. LEGAL STUD. EDUC. 147 (1995).

³⁹ Professor Bagley has emphasized the importance of “legal astuteness” as a possible source of competitive advantage. In an article in this special issue, she develops an integrated model of law and strategy. Bagley, *supra* note 6, at __.

⁴⁰ CONSTANCE E. BAGLEY, WINNING LEGALLY: HOW TO USE THE LAW TO CREATE VALUE, MARSHAL RESOURCES, AND MANAGE RISK 28 (2005).

⁴¹ *Id.* at 32-34.

⁴² *Id.* at 35.

⁴³ *Id.* at 36.

The third category focuses on the consumer. Businesses are encouraged to sell “safe and innovative products and services at a fair price.”⁴⁴ This is accomplished by laws (among others) governing product liability, antitrust, intellectual property, and consumer protection.

The fourth category addresses public welfare concerns “by promoting the effective administration of justice, collecting taxes and spending money, protecting fundamental rights, and protecting the environment.”⁴⁵ The administration of justice, for example, includes tort law, criminal law, and an impartial judicial system.⁴⁶

E. Approaches to Legal Strategy

Professor Bird has developed a valuable model that includes five approaches to legal strategy that he calls “The Five Paths of Firm Legal Strategy.”⁴⁷ While these approaches are not designed to serve as an evolutionary plan,⁴⁸ they do provide a transition from Bagley’s framework at Part I.D. of this article to the action plan discussed in the next section.

The first of the five approaches is avoidance—that is, attempts by companies to avoid legal requirements in an effort to reduce costs. For instance, some firms might decide to minimize safety programs because they conclude that it is more economical to pay fines than to comply with the law.⁴⁹

Second, some firms adopt an approach that focuses on compliance with the law, but little more. Bird’s description of the compliance approach brings to mind the classic article on organizational integrity by Harvard Business School Professor Lynn Paine, who concludes that compliance strategies are “lawyer driven” and designed to “prevent criminal misconduct.”⁵⁰

A third approach to legal strategy is prevention. This is where, Bird asserts, “a legally-based strategy begins to emerge. For the first time, legal requirements reinforce and advance business goals.”⁵¹ Citing examples like the Job Preferences Process that Home Depot developed after settling a class action alleging gender discrimination,⁵² he observes that, unlike the compliance approach, firms adopting a prevention approach “utilize their legal resources to achieve a strategic result—a competitive advantage.”⁵³

The fourth approach is labeled advantage, which elevates the law as it relates to strategy to the same position as other disciplines. An example is reframing legal problems as opportunities.⁵⁴ For example, environmental regulation provides numerous opportunities for reframing as companies redesign products that benefit the environment while creating value for customers (and ultimately for the firms that produce the products).⁵⁵

⁴⁴ *Id.* at 37.

⁴⁵ *Id.* at 39.

⁴⁶ *Id.*

⁴⁷ Bird, *Pathways*, *supra* note 1, at 12.

⁴⁸ *Id.*

⁴⁹ *Id.*

⁵⁰ Lynn Sharp Paine, *Managing for Organizational Integrity*, HARV. BUS. REV., Mar.-Apr. 1994, at 106, 113.

⁵¹ Bird, *Pathways*, *supra* note 1, at 23.

⁵² *Id.* at 23-24.

⁵³ *Id.* at 25.

⁵⁴ *Id.* at 26-27.

⁵⁵ SIEDEL, *supra* note 2, at 128.

The final approach is transformation, which takes the advantage approach one step further by achieving a sustainable competitive advantage.⁵⁶ As an example, Bird provides an in-depth analysis of the success of Lincoln Electric Company, which has developed a productive workforce through a legal policy in which the firm has relinquished its right to dismiss employees at will.⁵⁷

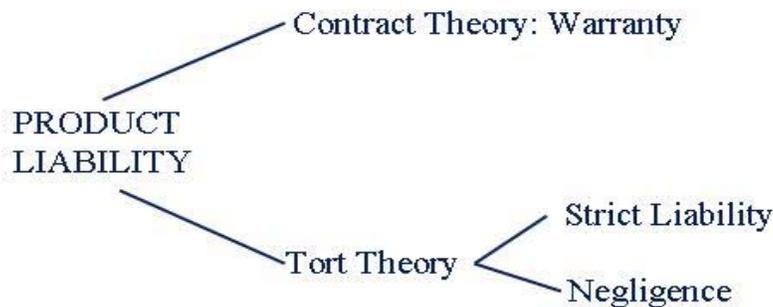
F. An Action Plan for Achieving Competitive Advantage

The final development in the “law as competitive advantage” field has been the creation of a plan for action that managers can follow in attempting to achieve competitive advantage. Called the “Manager’s Legal Plan,” the plan has four steps.⁵⁸

1. Management Understanding of the Law

The first step in the action plan, management understanding of the law, lays an important foundation in implementing the steps that follow, which in turn are necessary to achieve competitive advantage. A starting point for managers’ legal education is Bagley’s public policy framework described at Part I.D. For instance, the law of product liability is an important feature of several objectives of the law: promoting economic growth, promoting consumer welfare, and promoting the public welfare.⁵⁹ Managers should understand the basics of product liability, such as the three main theories of product liability depicted in Figure 1.

Figure 1



⁵⁶ Bird, *Pathways*, *supra* note 1, at 31.

⁵⁷ *Id.* at 33-38.

⁵⁸ SIEDEL, *supra* note 2, at 20-25.

⁵⁹ BAGLEY, *supra* note 40, at 26-42.

This foundational knowledge of the law is derived from a variety of sources. Business law courses, which are part of the core curriculum in business schools, are especially valuable because they provide future managers with the frameworks, concepts, and tools necessary for business decision making. Managers who do not have a fundamental understanding of tort law and contract law, for example, face difficulty in minimizing legal risks and taking advantage of law's value creating opportunities.

Attributive variables mentioned at Part I.C. are also important in establishing the knowledge base and mindset necessary to achieve competitive advantage. For example, corporate attorneys play an important role in on-the-job legal education. According to a survey of CEOs, the most important role of a corporate attorney is the ability to educate management regarding legal matters.⁶⁰

2. Coping with Legal Concerns

The second step of the action plan addresses the manner in which managers cope with legal concerns. This step represents the classical *reactive* management approach to the law that views lawyers as emergency room personnel who are brought in after a company is confronted with a legal problem such as litigation. Working in this reactive mode, managers and attorneys work together to settle cases or to complete the litigation process. Using Bird's analysis at Part I.E., this step is correlated with an avoidance approach. But Bird's compliance approach could also be viewed as primarily reactive in nature—for instance, when firms develop codes of conduct in reaction to legal requirements.

While they might not provide *sustainable* competitive advantage because they are fairly easy to imitate, several management processes and tools have been developed in recent years that provide managers with alternatives to the litigation process for resolving business disputes. The search for these alternatives originated over two decades ago when managers began to question why business disputes were outsourced to lawyers and the legal system when they (managers) possess the skills necessary to resolve conflict. In answering this question, a variety of processes, collectively known as Alternative Dispute Resolution (ADR), were developed that are based on three traditional models: (1) negotiation, (2) mediation, and (3) arbitration. The first two processes are not binding on companies unless they agree to the result, while arbitration can be either binding or non-binding.

Management tools have been developed that complement the process of ADR. For example, over 4000 operating companies have adopted a formal statement on ADR, pledging that they will use ADR techniques to resolve business disputes with companies who have made a similar pledge.⁶¹ Some firms utilize suitability screens, which are tools used by managers to decide whether to use binding or non-binding ADR processes and, if they choose binding processes, whether to use arbitration or to proceed with litigation.⁶² The Xerox Screen, for example, includes a series of questions about the parties, the nature of the dispute, the stakes

⁶⁰ SIEDEL, *supra* note 2, at 23 (citing Am. Corp. Counsel Ass'n, In-House Counsel for the 21st Century (Sept. 7, 2001), <http://www2.acc.com/Surveys/CEO/>).

⁶¹ *Id.* at 159-60.

⁶² *Id.*

involved, and the speed and cost of resolution. Managers use the answers to these questions in selecting an appropriate dispute resolution process.⁶³

Finally, almost every business deal today includes negotiation regarding an ADR contract clause. These clauses might call for use of an independent process such as arbitration if a dispute arises—or the processes might be linked. For example, the parties might start with negotiation, then move to mediation, and finally to arbitration.⁶⁴

The decision tree is another tool that managers and attorneys use to make settlement decisions. This method of legal analysis involves first depicting the legal issues in the form of a tree, and then adding probabilities to reflect the attorney's legal analysis and values that reflect financial gains and losses. Using weighted averages, an expected value of the litigation is then calculated and used as the basis for evaluating settlement offers.⁶⁵

3. Developing Strategies and Solutions to Prevent Future Legal Problems

Step Three of the action plan, the development of business strategies and solutions to prevent future legal problems, moves beyond the *ex post* reaction to legal concerns in Step Two to an emphasis on *ex ante* preventive strategies. This step, like Bird's prevention approach discussed in the previous section, represents the beginning of sustainable competitive advantage because it is difficult for many firms to replicate, possibly as result of the attitudinal and attributive variables discussed previously.⁶⁶

For instance, managers are often too busy to reflect on knowledge gained from Step Two and, even if they had the time, reflection requires discipline. According to a study by Russo and Schoemaker, managers spend 87% of their time gathering information and making decisions and only 13% of their time learning from their experience.⁶⁷

For example, after a product liability case has been settled or litigated, managers and their attorneys should reflect on their experience and develop legal strategies designed to prevent future litigation or at least to limit liability. They might decide, for instance, to create separate subsidiaries for the manufacture of products that create a high risk of product liability, thus creating a corporate veil that will protect the parent corporation from liability. They might develop disclaimers that will reduce warranty claims. And they might review the processes they use to design products and develop warnings.⁶⁸

Step Three also provides an opportunity for firms to think holistically about their dispute resolution processes and tools, rather than considering them in a piecemeal fashion after a dispute arises. Figure 2 illustrates one approach that links various dispute resolution elements discussed previously at Step Two.⁶⁹

Figure 2

⁶³ CATHERINE CRONIN-HARRIS, BUILDING ADR INTO THE CORPORATE LAW DEPARTMENT 105-07 (1997).

⁶⁴ SIEDEL, *supra* note 2, at 160-63.

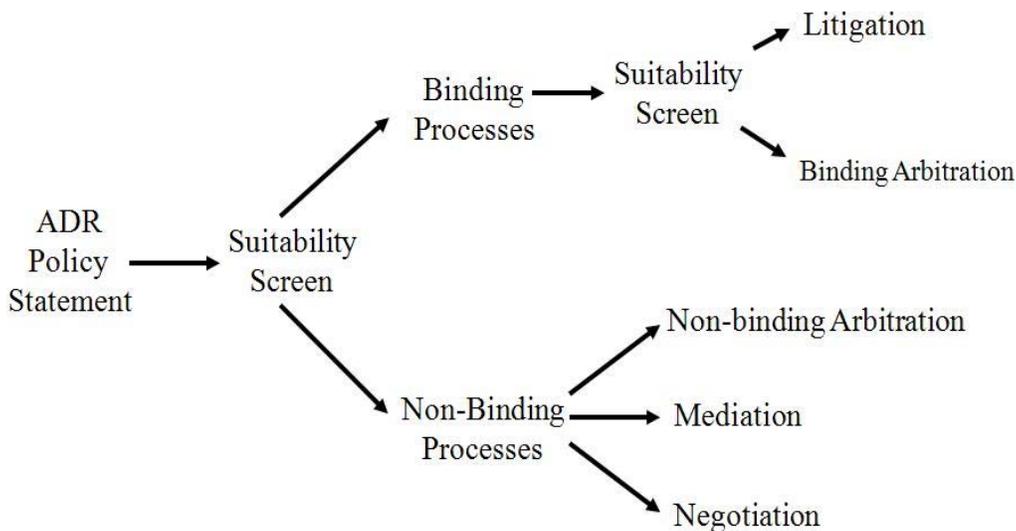
⁶⁵ *Id.* at 152-57.

⁶⁶ See *supra* text accompanying notes 32-35.

⁶⁷ J. EDWARD RUSSO & PAUL J.H. SCHOEMAKER, WINNING DECISIONS: GETTING IT RIGHT THE FIRST TIME 9 (2001).

⁶⁸ SIEDEL, *supra* note 2, at 47-52.

⁶⁹ *Id.* at 162.



4. Reframing Legal Concerns as Business Concerns and Opportunities

The fourth step, which is akin to Bird’s advantage and transformation approaches, provides the greatest opportunity for sustainable competitive advantage because it is the most difficult step for rivals to imitate. At this step, the focus turns to reframing legal concerns as business concerns and opportunities. To use a metaphor developed by William Ury in his book *Getting Past No*,⁷⁰ managers should “go to the balcony” to gain a big picture perspective of the opportunities available when legal concerns are reframed as business concerns.

In addressing product liability, for instance, companies must explore foreseeable uses (and misuses) of their products to develop appropriate design changes and warnings. This can be an uncomfortable process for managers who feel that customers who misuse products should not be allowed to recover damages. However, by reframing their legal concern as a business concern, managers can perceive the process of searching for foreseeable uses as a form of marketing research. Consumers who use products for purposes other than the intended ones are often, in effect, telling firms that they must do so because existing products do not meet their needs. This provides an opportunity for firms to develop new products to meet those needs.⁷¹

To use the words of legendary General Motors CEO Alfred Sloan, in a letter to shareholders, “[t]o discuss Consumer Research as a functional activity would give an erroneous impression. In its broad implications, it is more in the nature of an OPERATING PHILOSOPHY, which, to be fully effective, must extend through all phases of the business . . . [and] serve the customer in ways in which the customer wants to be served.”⁷² Through the product liability prevention process, among others, the law becomes one of the “phases of the business” that provides an excellent opportunity to serve customers in the way they want to be served.

⁷⁰ WILLIAM URY, *GETTING PAST NO* 11 (1993).

⁷¹ SIEDEL, *supra* note 2, at 52-55.

⁷² *MARKETING IN PROGRESS* 199 (Hiram C. Barksdale ed. 1964).

The four-step Manager's Legal Plan can be used as a teaching tool as well as a management plan to achieve competitive advantage.⁷³ For example, Professor Robert Aalberts of the University of Nevada-Las Vegas uses the plan as the basis for an assignment in his Executive MBA course.⁷⁴ After providing students with an understanding of legal concepts (Step One), he asks teams of students to work on an actual legal problem by analyzing how the company reacted to the problem (Step Two).⁷⁵ For instance, if the company had been sued, did it continue the litigation or settle? His student teams have selected legal problems relating to, among other topics, "workers' compensation, covenants not to compete, premises liability, Americans with Disabilities Act (ADA), construction defect litigation, employment contracts, sexual harassment."⁷⁶

Professor Aalberts then asks the teams to develop business strategies that will prevent or at least minimize future legal problems (Step Three). Finally, he asks the teams to reframe the legal problem as a business opportunity (Step Four). Professor Aalberts reports that, after completing this assignment, some team members have used their team's plans at work.⁷⁷

Part I has presented a holistic framework that integrates the work of several U.S. scholars who have focused on the linkage between law and competitive advantage. The common theme underlying their work is that, "[l]aw is the last great untapped source of competitive advantage."⁷⁸ We now turn to a parallel development in Europe, the Proactive Law Movement.

II. THE PROACTIVE LAW MOVEMENT IN EUROPE

Over the past decade, the Proactive Law Movement has gained momentum in Europe. In this section we review the history and current state of the movement, describe the recognition the movement has received, and analyze the relationship between Proactive Law and the parallel "law for competitive advantage" movement in the United States. As a starting point, Proactive Law is defined as:

. . . a future-oriented approach to law placing an emphasis on legal knowledge to be applied before things go wrong. It comprises a way of legal thinking and a set of skills, practices and procedures that help to identify opportunities in time to take advantage of them – and to spot potential problems while preventive action is still possible. In addition to avoiding disputes, litigation and other hazards, Proactive Law seeks ways to use the law to create value, strengthen relationships and manage risk.⁷⁹

⁷³ See George J. Siedel, *The Sixth Strategy: Integrating the Law School and Business School Case Methods*, LAW TEACHER, Fall 2008, at 15, available at <http://lawteaching.org/lawteacher/2008fall/lawteacher2008fall.pdf>.

⁷⁴ E-mail from Robert J. Aalberts, Professor, Department of Finance, University of Nevada, Las Vegas (Aug. 25, 2009, 14:12:00 EST) (on file with authors).

⁷⁵ *Id.*

⁷⁶ *Id.*

⁷⁷ *Id.*

⁷⁸ Bird, *Pathways*, *supra* note 1, at 41 (citing Larry Downes, *First, Empower All the Lawyers*, HARV BUS. REV., Dec. 2004, at 19, 19).

⁷⁹ Nordic School of Proactive Law, Welcome to the website of the Nordic School of Proactive Law, <http://www.proactivelaw.org> (last visited July 1, 2010). This site is maintained under the leadership of one of the

A. Origins and Current Status of the Proactive Law Movement

The first publication relating to what is now known as Proactive Law Movement was a paper entitled “Quality Improvement through Proactive Contracting” that Helena Haapio presented at the Annual Quality Congress of the American Society for Quality in Philadelphia in 1998.⁸⁰ This paper was followed by a series of publications and the first Proactive Law conference, which was held in Helsinki, Finland, in 2003. This and other conferences eventually led to the formation of the Nordic School of Proactive Law⁸¹ and the ProActive ThinkTank⁸².

Another early stream of the movement can be traced to the interaction of law with information and communication technologies and the legal discipline of *Law and Informatics* (in Swedish “*rättsinformatik*”). Cecilia Magnusson Sjöberg, Professor of Law and Information Technology and Director of the Swedish Law & Informatics Research Institute⁸³ at the University of Stockholm became one of the founders of the Nordic School of Proactive Law. The article “Safe Sales in Cyberspace,”⁸⁴ which focused on building quality assurance, risk management, and legal problem prevention into electronic sales, led to an early bridge between the practitioners and researchers in the fields of Proactive Contracting and Law and Informatics. An attempt to merge these lines of interests associated with Proactive Law resulted in the second Proactive Law conference which was held in Stockholm, Sweden, in 2005. The underlying conference idea, as expressed by Magnusson Sjöberg, the Conference Chair, was the fact that “[c]ontracts, information resources and IT are valuable assets and a source of strategic advantage. They create value and have fundamental impact on financial results. Consequently, they need to be planned, secured and protected effectively.”⁸⁵

The Nordic School is a network of researchers and practitioners from Denmark, Finland, Iceland, Norway and Sweden, each of whom has an interest in Proactive Law.⁸⁶ The Nordic School has been instrumental in the creation of the ProActive ThinkTank, led by a core team

pioneers of Proactive Law, Professor Cecilia Magnusson Sjöberg, Director of the Swedish Law & Informatics Research Institute at the University of Stockholm.

⁸⁰ Helena Haapio & Annika Varjonen, *Quality Improvement through Proactive Contracting: Contracts Are Too Important to Be Left to Lawyers!* 52 PROC. OF ANN. QUALITY CONGRESS 243 (1998). An abstract is available at <http://www.asq.org/qic/display-item/index.html?item=10690&item=10690>. This conference paper was later published as Helena Haapio, *Preventive Lawyering in International Sales - Using Contract Reviews to Integrate Preventive Law, Risk Management, and Quality*, PREVENTIVE L. REP., Winter 1997, at 16.

⁸¹ Nordic School of Proactive Law, *supra* note 79.

⁸² Nordic School of Proactive Law, Proactive ThinkTank, <http://www.proactivethinktank.com> (last visited July 1, 2010); International Association for Contract and Commercial Management, ProActive Think Tank Home Page, <http://www.iaccm.com/proactive> (last visited July 1, 2010). *See also* Helena Haapio, *Introduction to Proactive Law: A Business Lawyer's View*, in A PROACTIVE APPROACH 21, 26 (Scandinavian Studies in Law vol. 49, Peter Wahlgren ed. 2006) [hereinafter A PROACTIVE APPROACH].

⁸³ *See* Institutet för Rättsinformatik, Welcome to The Swedish Law & Informatics Research Institute, <http://www.juridicum.su.se/iri/english> (last visited July 1, 2010).

⁸⁴ Helena Haapio & Anita Smith, *Safe Sales in Cyberspace*, 18 AM. CORP. COUNS. ASS'N DOCKET 24 (2000), *reprinted in* INTERNATIONAL CONTRACT MANUAL – CONTRACT CHECKLISTS (Albert Kritzer ed. Supp. 2000), available at <http://www.cisg.law.pace.edu/cisg/biblio/haapiosmith.html>.

⁸⁵ Cecilia Magnusson Sjöberg, *Introduction*, in A PROACTIVE APPROACH, *supra* note 82, at 13, 15.

⁸⁶ *See* Nordic School of Proactive Law, Contact Us, <http://www.juridicum.su.se/proactivelaw/main/planning.html> (last visited July 1, 2010).

from Denmark, Finland, France, the Netherlands, and the United Kingdom.⁸⁷ The mission of the ThinkTank is to provide a forum for business leaders, lawyers, academics and other professionals to discuss, develop and promote the proactive management of relationships, contracts and risks and the prevention of legal uncertainties and disputes.⁸⁸ Among the publications following conferences organized by the Nordic School are three English language books, *A Proactive Approach*,⁸⁹ *Corporate Contracting Capabilities*,⁹⁰ and *A Proactive Approach to Contracting and Law*.⁹¹ Some of the early work of the Nordic School is available in Finnish or Swedish only.⁹²

Through the research and publications of participants in the Nordic School, the meaning of Proactive Law has been refined and clarified. Proactive Law has two dimensions, both of which emphasize *ex ante*, forward-looking action: (1) a preventive dimension and (2) a promotive dimension.

The preventive dimension originated with the work of Louis Brown, the “Father of Preventive Law.”⁹³ One of Brown’s fundamental premises was that in curative law, it is essential for the lawyer to predict what a *court* will do, while in Preventive Law, it is essential to predict what *people* will do.⁹⁴ An experienced practitioner as well as a law professor, Brown observed that legal disputes arise because people feel aggrieved, not because someone has violated a legal right.⁹⁵

Brown’s work on preventive law was targeted toward lawyers. While influenced by his work, the Nordic School has taken his work one step further by emphasizing the importance of collaboration between legal professionals and other functions and disciplines. In the words of Soile Pohjonen, Docent at the University of Helsinki, “[Preventive Law] favours the lawyer’s viewpoint, i.e., the prevention of legal risks and problems. In Proactive Law, the emphasis is on achieving the desired goal in particular circumstances where legal expertise works in collaboration with the other types of expertise involved. In Proactive Law, the need for dialogue between different understandings is emphasized.”⁹⁶

⁸⁷ See International Association for Contract and Commercial Management, ProActive Think Tank Home Page, Core Team, <http://www.iaccm.com/proactive/index.php?thispage=coreteam> (last visited July 1, 2010).

⁸⁸ International Association for Contract and Commercial Management, ProActive ThinkTank Mission Statement, <http://www.juridicum.su.se/proactivelaw/main/thinktank/missionstatement.pdf> (last visited May 1, 2010).

⁸⁹ A PROACTIVE APPROACH, *supra* note 82.

⁹⁰ CORPORATE CONTRACTING CAPABILITIES, CONFERENCE PROCEEDING AND OTHER WRITINGS (Soili Nystén-Haarala ed., 2008).

⁹¹ A PROACTIVE APPROACH TO CONTRACTING AND LAW (Helena Haapio ed., 2008).

⁹² E.g., ENNAKOIVA SOPIMINEN – LIKETOIMIEN SUUNNITTELU, TOTEUTTAMINEN JA RISKIEN HALLINTA [Proactive Contracting – Planning, Implementing and Managing Risk in Business Transactions] (Soile Pohjonen, ed., 2002) and EX ANTE – ENNAKOIVA OIKEUS [Ex ante – Proactive Law] (Soile Pohjonen, ed., 2005).

⁹³ Edward A. Dauer, *The Role of Culture in Legal Risk Management*, in A PROACTIVE APPROACH, *supra* note 82, at 93, 93-94.

⁹⁴ *Id.* See generally LOUIS M. BROWN, *LAWYERING THROUGH LIFE – THE ORIGIN OF PREVENTIVE LAW* (1986); LOUIS M. BROWN & EDWARD A. DAUER, *PLANNING BY LAWYERS: MATERIALS ON NONADVERSARIAL LEGAL PROCESS* (1978); LOUIS M. BROWN, *PREVENTIVE LAW* (1950).

⁹⁵ Dauer, *supra* note 93, at 94.

⁹⁶ Soile Pohjonen, *Proactive Law in the Field of Law*, in A PROACTIVE APPROACH, *supra* note 82, at 53, 54. See also Soile Pohjonen, *Law and Business – Successful Business Contracting, Corporate Social Responsibility and Legal Thinking*, TIDSKRIFT UTGIVEN AV JURIDISKA FÖRENINGEN I FINLAND (JFT) 470, 477 (2009), available at

The second dimension of Proactive Law, the promotive dimension, has a positive and constructive emphasis. In explaining the difference between the preventive and promotive aspects of Proactive Law, concepts relating to wellness provide a useful analogy. A person who is afflicted with a serious disease needs immediate medical care, sometimes in an emergency room. This *reactive* approach is analogous to bringing in lawyers after a company has been sued or prosecuted by the government.

There are two proactive paths to good health that might minimize trips to the emergency room. One path emphasizes prevention in the form of, for example, vaccinations to prevent the disease. In the same vein (no pun intended), Proactive Law plays a *preventive* role by “‘vaccinating’ business people against the ‘disease’ of legal trouble, disputes, and litigation.”⁹⁷ The other path to good health emphasizes an approach that promotes a healthy lifestyle. In a business context, the goal of this *promotive* aspect of Proactive Law “is to embed legal knowledge and skills in clients’ strategy and everyday actions to actively promote business success, ensure desired outcomes, and balance risk with reward.”⁹⁸

The preventive and promotive dimensions of the Proactive Law Movement are well grounded in psychological theory. For instance, Tory Higgins, a professor of management at the Columbia Business School who is also a professor of psychology, has developed a psychological theory called the Regulatory Focus Theory that focuses on motivations and how people attempt to achieve their goals.⁹⁹ According to Higgins, there are two orientations toward goals: (1) a prevention focus that emphasizes safety, responsibility and security and (2) a promotion focus that emphasizes hopes, accomplishments and advancements.¹⁰⁰ When people are presented with a goal, the way they pursue the goal and their reaction to their accomplishments in achieving the goal depend on whether they have a prevention focus or a promotion focus.¹⁰¹

For example, people with a prevention focus view goals as minimal targets that produce a low-intensity response when the goal is achieved. By contrast, people with a promotion focus view goals as maximal targets and “achievement of the goal results in feelings of high-intensity happiness instead of low-intensity calm.”¹⁰² By incorporating both a preventive and a promotive focus, the Proactive Law Movement utilizes these motivation theories to encourage the simultaneous achievement of both legal goals (which are often preventive) and business goals (which tend to be promotive).

B. The Impact of the Proactive Law Movement

<http://www.helsinki.fi/oikeustiede/omasivu/pohjonen/Law%20and%20Business.pdf> [hereinafter Pohjonen, *Law and Business*].

⁹⁷ Haapio, *supra* note 82, at 22.

⁹⁸ *Id.* at 24.

⁹⁹ See Higgins Lab, Regulatory Focus, <http://www.columbia.edu/cu/psychology/higgins/research.html> (last visited July 9, 2010).

¹⁰⁰ *Id.*

¹⁰¹ Kyle J. Mayer & Libby Weber, *Unpacking Contract Capabilities: Shaping Behavior by Implementing Appropriate Contract Framing* 8 (Feb. 22, 2009), available at <http://ssrn.com/abstract=1349247>. See also Libby Weber, *The Right Frame of Mind for M&A: The Post-Merger Impact of Deal Frames on Target Management Behavior* (Feb. 25, 2009), available at <http://ssrn.com/abstract=1349209>.

¹⁰² Mayer & Weber, *supra* note 101, at 9.

The Proactive Law Movement originally focused on business applications such as contracting, e-commerce, project management, risk management, and legal document management.¹⁰³ The movement's scope was later expanded to include other private and public sector applications. In 2008, the movement gained recognition in the public policy arena when the European Economic and Social Committee (EESC)¹⁰⁴ adopted the proactive approach in an Opinion directed toward improving regulation in the European Union (EU). This section will first provide background information on the EESC and will then analyze the Opinion.

1. The Mission of the European Economic and Social Committee (EESC)

The EESC is a consultative body set up by the Rome Treaties in 1957.¹⁰⁵ Its main task is to advise the European Parliament, the Council of the European Union, and the European Commission.¹⁰⁶ The EESC consists of 344 members representing (among others) Europe's employers' organizations, trade unions, consumer groups, and professional associations.¹⁰⁷ The EESC channels the views of these interest groups to the larger EU institutions and plays an active role in the processes of shaping Community policies, preparing Community decisions, and involving civil society organizations at both national and European level.¹⁰⁸ At the EU level, proposals for legislation are drawn up by the European Commission. As required by the Treaties, in a large number of policy areas these proposals have to be referred to the EESC.¹⁰⁹

The EESC issues its views in the form of Opinions that are published in the *Official Journal of the European Union*.¹¹⁰ While it is mandatory for the EESC to be consulted on certain issues stipulated in the Treaties, the EESC can also initiate Opinions.¹¹¹ The Commission reports to the EESC on action taken on its Opinions. The EESC own-initiative Opinions are designed to raise awareness in the decision-making bodies (especially the Commission) about subjects that have attracted little, if any, attention.¹¹² Once adopted, the Opinions are available on the EESC website.¹¹³ After publication in the *Official Journal of the European Union* they can also be

¹⁰³ Cecilia Magnusson Sjöberg, *Proactive ICT Law in the Nordic Countries*, in A PROACTIVE APPROACH TO CONTRACTING AND LAW, *supra* note 91, at 47.

¹⁰⁴ The European Economic and Social Committee, <http://www.eesc.europa.eu> (last visited July 6, 2010).

¹⁰⁵ For the roles and functions of the EESC, see Treaty Establishing the European Community, art. 258-262, Dec. 24, 2002, 2002 O.J. (C 325) 137, *available at* http://eur-lex.europa.eu/en/treaties/dat/12002E/pdf/12002E_EN.pdf, as amended by the Lisbon Treaty. For the latter and a consolidated version, see Council of the European Union, Treaty of Lisbon, <http://www.consilium.europa.eu/showPage.aspx?id=1296&lang=en> [hereinafter Lisbon Treaty], art. 301-304. *See also* The European Economic and Social Committee, The EESC in 10 Points, http://www.eesc.europa.eu/resources/docs/cese_10q_en.pdf (last visited July 9, 2010) [hereinafter EESC 10 Points]

¹⁰⁶ *See* Lisbon Treaty, *supra* note 105, art. 304.

¹⁰⁷ The European Economic and Social Committee, Frequently Asked Questions, <http://www.eesc.europa.eu/?i=portal.en.faq> (last visited June 16, 2010) [hereinafter EESC FAQ].

¹⁰⁸ *Id.* *See also* EESC 10 Points, *supra* note 105.

¹⁰⁹ EESC FAQ, *supra* note 107.

¹¹⁰ Official Journal of the European Union, <http://eur-lex.europa.eu/JOIndex.do?ihmlang=en> (last visited June 16, 2010).

¹¹¹ Lisbon Treaty, *supra* note 105, art. 304.

¹¹² EESC 10 Points, *supra* note 105.

¹¹³ The European Economic and Social Committee, Documents, <http://www.eesc.europa.eu/?i=portal.en.documents> (last visited July 8, 2010).

downloaded through the EUR-Lex service,¹¹⁴ which is available in twenty-three official languages of the European Union.

In the EU, the European Commission, the European Parliament, and the EESC have long promoted and argued for *better regulation, simplification* and *communication* as main policy objectives.¹¹⁵ In the words of Jorge Pegado Liz, the Chairman of the Single Market Observatory (SMO) of the EESC:

The reduction of administrative costs by 25% by 2012, agreed by the European Spring Summit 2007, is one of our main priorities. This move could give a 150 billion EURO boost to the European economy. The choice of the right form of European intervention is important to ensure a fair, competitive and well functioning Internal Market. Alternative mechanisms, such as self- and co-regulation, become more and more alternatives to legislation as they might help to reduce unnecessary red tape¹¹⁶

The source of Proactive Law was private lawmaking: contracting in the business-to-business context.¹¹⁷ Yet the proactive approach soon expanded beyond this. We now turn to the EESC Opinion, which explores the ways in which the Proactive Law approach can act as a step towards better public lawmaking and, at the same time, serve as a means of avoiding over-detailed and unnecessary regulation.

2. The EESC's Recognition of the Proactive Law Movement

The Better Regulation agenda, along with European self-regulation and co-regulation initiatives, led to contact between representatives of the EESC SMO and the Nordic School of Proactive Law. Helena Haapio's presentation on proactive legal care in the context of corporate contracting, "An Ounce of Prevention... Proactive Legal Care for Corporate Contracting Success,"¹¹⁸ at the Conference on Private Law and the Many Cultures of Europe¹¹⁹ led Pegado Liz to consider possibilities for applying the Proactive Law approach to better regulation at the EU Level. He convinced the EESC to consider the topic for an own-initiative Opinion, established a study group within the SMO, became the Rapporteur, and invited Haapio to be the Expert in exploring the topic further.¹²⁰ After a year of preparation work and several study group

¹¹⁴ Eur-Lex, Access to European Union Law, <http://eur-lex.europa.eu/en/index.htm> (last visited July 8, 2010).

¹¹⁵ See Opinion of the European Economic and Social Committee on 'The proactive law approach: a further step towards better regulation at EU level', 2009 O.J. (C 175) § 4.2, available at <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:C:2009:175:0026:0033:EN:PDF> [hereinafter EESC Opinion].

¹¹⁶ European Economic and Social Committee, Foreword of Mr. Pegado Liz, Chairman of the Single Market Observatory, <http://www.eesc.europa.eu/?i=portal.en.self-and-co-regulation-foreword> (last visited July 8, 2010).

¹¹⁷ See Nordic School of Proactive Law, *supra* note 79; Pohjonen, *Law and Business*, *supra* note 96, at 477.

¹¹⁸ This paper was later published in Helena Haapio, *An Ounce of Prevention . . . Proactive Legal Care for Corporate Contracting Success*, JFT TIDSKRIFT UTGIVEN AV JURIDISKA FÖRENINGEN I FINLAND (JFT) 39 (2007).

¹¹⁹ This Conference was hosted by the PriME Research Project (Private Law in a Multicultural and Multilingual European Society) and the Institute of International Economic Law at the University of Helsinki in August 2006.

¹²⁰ See generally Jorge Pegado Liz, EESC Opinion on the Proactive Law Approach: A Further Step Towards Better Regulation at EU level, presentation at the 1st European Proactive Law Symposium, ICN Business School, Nancy, France (Oct. 14, 2009).

meetings, at its plenary session on 3 December 2008, the EESC adopted its Opinion on, “*The proactive law approach: a further step towards better regulation at EU level.*”¹²¹

In the Opinion, the EESC makes reference to the work of the Nordic School of Proactive Law¹²² and urges a paradigm shift in EU law, stating:

The time has come to give up the centuries-old reactive approach to law and to adopt a proactive approach. It is time to look at law in a different way: to look forward rather than back, to focus on how the law is used and operates in everyday life and how it is received in the community it seeks to regulate. While responding to and resolving problems remain important, preventing causes of problems is vital, along with serving the needs and facilitating the productive interaction of citizens and businesses.¹²³

After noting that Proactive Law “is about enabling and empowering—it is done by, with and for the users of the law, individuals and businesses,” the Opinion goes on to note that “the vision here is of a society where people and businesses are aware of their rights and responsibilities, can take advantage of the benefits that the law can confer, know their legal duties so as to avoid problems where possible, and can resolve unavoidable disputes early using the most appropriate methods.”¹²⁴

The Opinion summarizes the main steps and documents of the European Commission, the European Parliament, and the EESC towards better regulation.¹²⁵ Its purpose is to show how the Proactive Law approach can favor better regulation by providing a new way of thinking that “takes as its starting point the real-life needs and aspirations of individuals and businesses.”¹²⁶ By adopting this own-initiative Opinion, “the EESC emphasises that ‘better regulation’ should be geared towards an optimal mix of regulatory means which best promote societal objectives and a well functioning, citizen- and business-friendly legal environment.”¹²⁷

After referring to one of the basic notions of the Proactive Law approach, namely the importance of reaching desired objectives (rather than focusing on legal rules and their formal enforcement alone), the Opinion states a principle that holds true both in corporate strategy and public lawmaking, which is that “[t]o set the desired goals and to secure the most appropriate mix of means to achieve them requires involving stakeholders early, aligning objectives, creating a shared vision, and building support and guidance for successful implementation from early on.”¹²⁸ The Opinion further states:

When drafting laws, the legislator should thus be concerned about producing operationally efficient rules that reflect real-life needs and are implemented in a manner that the ultimate objectives of those rules are accomplished.

¹²¹ EESC Opinion, *supra* note 115.

¹²² *Id.* §§ 3.8, 5.2.

¹²³ *Id.* § 1.4

¹²⁴ *Id.* § 1.5.

¹²⁵ *Id.* §§ 4.2-4.6.

¹²⁶ *Id.* § 6.9.

¹²⁷ *Id.* § 2.2.

¹²⁸ *Id.* §1.6.

The life cycle of a piece of legislation does not begin with the drafting of a proposal or end when it has been formally adopted. A piece of legislation is not the goal; its successful implementation is. Nor does implementation merely mean enforcement by institutions; it also means adoption, acceptance and, where necessary, a change of behaviour on the part of the intended individuals and organisations.¹²⁹

After noting that the EESC is convinced that the new way of thinking represented by the proactive approach is generally applicable to law and law-making, the Opinion argues that “rules and regulations are not the only way nor always the best way to achieve the desired objectives; at times, the regulator may best support valuable goals by refraining from regulating and, where appropriate, encouraging self-regulation and co-regulation.”¹³⁰ The Opinion concludes:

The EESC believes that the single market can benefit greatly when EU law and its makers – legislators and administrators in the broadest sense – shift their focus from inward, from inside the legal system, rules and institutions, to outward, to the users of the law: to society, citizens and businesses that the legal system is intended to serve.

While the transposition and implementation of laws are important steps towards better regulation at EU level, regulatory success should be measured by how the goals are achieved at the level of the users of the law, EU citizens and businesses. The laws should be communicated in ways that are meaningful to their intended audience, first and foremost to those whose behaviour is affected and not just to the relevant institutions and administrators.¹³¹

The EESC recommends that the Commission, the Council and the European Parliament adopt the Proactive Law Approach when planning, drawing up, revising and implementing Community law and encourage Member States also to do so wherever appropriate.¹³² According to the Opinion, the application of the Proactive Law approach should be considered systematically in all lawmaking and implementation within the EU. “The EESC strongly believes that by making this approach not only part of the Better Regulation agenda, but also a priority for legislators and administrators at the EU, national and regional levels, it would be possible to build a strong legal foundation for individuals and businesses to prosper.”¹³³

C. Proactive Law and Competitive Advantage

Over the past decade, scholars on both sides of the Atlantic have developed new frameworks, concepts and tools for changing the role of law in business decision making. In the United States, the focus has been on using the law for competitive advantage, while in Europe a growing

¹²⁹ *Id.* §§ 2.4-2.5.

¹³⁰ *Id.* § 1.7.

¹³¹ *Id.* §§ 1.8-1.9.

¹³² *Id.* § 2.8. *See also* Press Release, European Economic and Social Committee, The Proactive Law Approach: A Novelty (Dec. 16, 2008), available at <http://www.eulib.com/proactive-approach-novelty-long-emphasis-legal-3775>.

¹³³ EESC Opinion, *supra* note 115, § 1.10.

number of scholars (along with practitioners and EU thought leaders) have called for a paradigm shift through the Proactive Law approach.

Although on the surface the two movements appear to emphasize diverse elements, in fact there is considerable overlap that is illustrated by the Manager's Legal Plan discussed at Part I.F. In essence, after a manager's legal knowledge base has been established in Step One, the plan starts with the traditional reactive approach to the law in Step Two, a step that is unavoidable when litigation arises. In the third step, the focus turns to learning from Step Two by preventing or at least minimizing legal concerns in the future. Using the metaphor of "going to the balcony," the fourth step encourages managers to reframe legal concerns as business concerns and opportunities.

The Proactive Law philosophy blends well with the four steps of the Manager's Legal Plan. Proactive Law first emphasizes that managers should understand their legal responsibilities and duties, which is Step One of the Manager's Legal Plan. To avoid the drawbacks of the traditional reactive approach to the law (Step Two), Proactive Law recommends two alternatives. The first is a preventive approach that emphasizes collaboration between legal and other professionals, which is similar to Step Three. The second alternative recommends a promotive approach that, like Step Four, encourages managers to think broadly about the law so that it becomes embedded into the development and implementation of a business strategy and is seen as a source of opportunities and not just of risks and threats.

We now turn to an example of this blend by applying its concepts to the contracting process, which we call proactive contracting. While often neglected by managers, proactive contracting offers many opportunities to use Proactive Law for competitive advantage. Proactive contracting and other areas of the law affecting managers are explored in greater depth in our forthcoming book *Proactive Law for Managers: A Hidden Source of Competitive Advantage*.¹³⁴

III. PROACTIVE CONTRACTING FOR COMPETITIVE ADVANTAGE

The Manager's Legal Plan has been applied to several of the most difficult and controversial areas of business law, including product liability, worker's compensation, wrongful discharge, sexual harassment, and environmental regulation.¹³⁵ This section will use contract law and the business contracting process to illustrate how Proactive Law can be combined with the Manager's Legal Plan to secure competitive advantage. Contracts offer an especially appropriate application because, as noted in a leading book on managerial responsibilities, "[o]btaining a contract is the primary goal of a business entity."¹³⁶ Contracts and contract law lie at the core of procurement and sales, and all business functions and activities—including research and development, finance, accounting, strategy, human resources, information technology, operations management, research and development, outsourcing, and networking—depend on the success of the contracting process.

¹³⁴ GEORGE J. SIEDEL & HELENA HAAPIO, *PROACTIVE LAW FOR MANAGERS: A HIDDEN SOURCE OF COMPETITIVE ADVANTAGE* (forthcoming 2010).

¹³⁵ SIEDEL, *supra* note 2, at 26.

¹³⁶ O. Lee Reed et al., *The Role of Contracts in the Introductory and Only Law Course That Most Business Students Will Ever Take*, 9 J. LEGAL STUD. EDUC. 1, 14 n.23 (1990) (quoting AM. CORPORATE COUNSEL ASS'N, *LEGAL RESPONSIBILITIES OF CORPORATE MANAGERS* 45 (1985)).

The pre-eminence of contract law is verified by surveys of business executives and corporate attorneys who consider contract law to be one of the most important legal topics for managers.¹³⁷ As Ohio State University Professor Elliott Klayman observed, “[c]ontracts are the thread which enables business to weave commercial patterns.”¹³⁸ Stated another way by Tim Cummins, CEO of the International Association for Contract and Commercial Management (IACCM), “[c]ontracts lie at the heart of most business relationships, certainly within Western cultures and economies, and increasingly among all companies or entities that seek to operate in an international market.”¹³⁹

A. Step One: Management Understanding of the Law

Step One of the four-step Manager’s Legal Plan described at Part I.F. calls for management understanding of the law. For reasons noted in the introduction to Part III, every business student should acquire what Haapio calls “Contractual Literacy”¹⁴⁰ in the core business law course. In addition to recognizing when they are entering into a contract (which might not involve documents bearing the heading “Contract”), they should be familiar with the elements of a legally binding contract and understand that these requirements might vary depending on the jurisdiction and the subject matter of the contract. In many contexts, Contractual Literacy also includes an understanding of legal guidelines for ethical dilemmas that arise during negotiations. These guidelines include issues such as whether the contract violated any fiduciary duties, whether either party engaged in fraudulent conduct, or whether the deal was unconscionable.

Beyond questions relating to the express terms negotiated by the parties to a contract, Contractual Literacy requires management understanding of invisible terms that are implied by law, as illustrated by Figure 3.¹⁴¹ As Haapio notes, “[s]ometimes the CISG becomes part of the contract, without the parties being aware of that fact. Trade usage and practice may become part of the contract as well. These may bring along requirements, liabilities and remedies that the parties did not know existed.”¹⁴²

Figure 3

¹³⁷ *Id.* at 13-14.

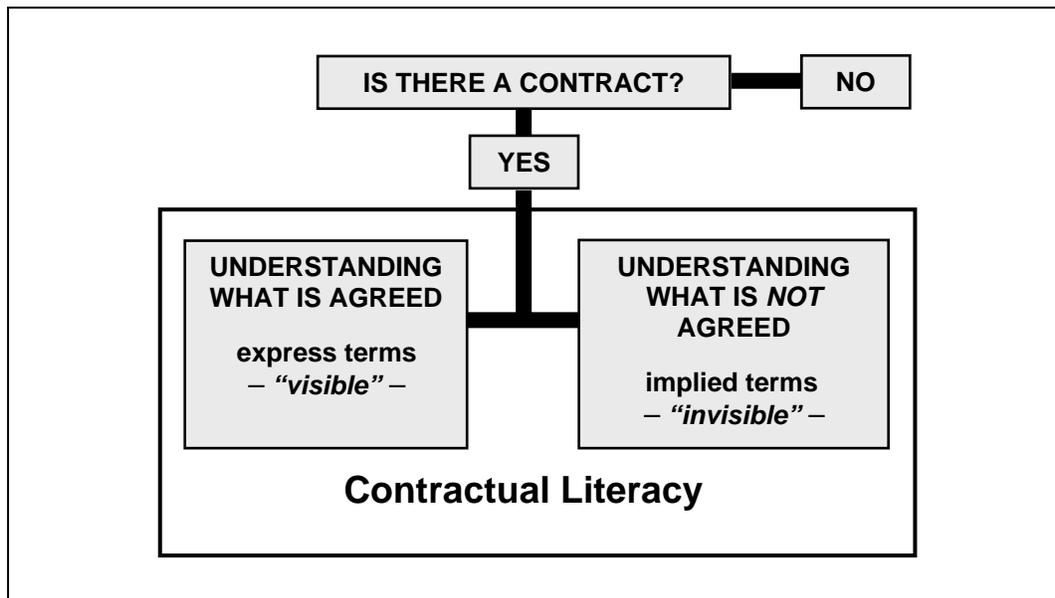
¹³⁸ *Id.* at 14 n.21 (quoting Elliot Klayman & Kathleen Nesser, *Eliminating the Disparity Between the Business Person's Needs and What is Taught in the Basic Business Law Course*, 22 AM. BUS. L.J. 41, 47 (1984)).

¹³⁹ Tim Cummins, *Best Practices in Commercial Contracting*, in A PROACTIVE APPROACH, *supra* note 82, at 131, 132.

¹⁴⁰ Helena Haapio, *Business Success and Problem Prevention Through Proactive Contracting*, in A PROACTIVE APPROACH, *supra* note 82, at 149, 169.

¹⁴¹ *Id.* at 170.

¹⁴² *Id.* at 171.



B. Step Two: Coping with Legal Concerns

In Step Two, managers use the legal knowledge acquired in Step One when working with attorneys to address legal concerns that arise in the workplace. This is the traditional reactive, *ex post*, “law as an emergency room” step described previously at Part I.F.

Let’s assume, for example, that Printer, a small U.S. printing company with a solid reputation and a large customer base, has leased computer hardware from a large, financially powerful U.S. firm, Lessor.¹⁴³ After delivery, Printer realizes that the hardware does not meet its composition needs because there is no application program. As a result, Printer stops payments on the lease and sues Lessor for lost profits. In the complaint, Printer alleges that Lessor breached the contract because its sales representative promised to provide Printer with the application program at no extra charge.

The general manager of Lessor reacts to the litigation by moving to emergency room mode—that is, by hiring an attorney to defend the case. In conferring with the attorney, the general manager learns that Lessor has a very good case because: (1) neither the contract nor Printer’s request for a proposal mentioned the application program and (2) the sales representative was not authorized to offer the application program for free. Furthermore, Lessor’s only application program had been pulled off the market because of technical problems. Lessor is in the process of developing a new application program that has great potential for financial success, but the new program needs substantial field development.

¹⁴³ This example is based on a simulation entitled Rapid Printing vs. Scott Computers. See George J. Siedel, *Interdisciplinary Approaches to Alternative Dispute Resolution*, 10 J. LEGAL STUD. EDUC. 141, 152 (1992). See also Anne L. Lytle, Jeanne M. Brett & Debra L. Shapiro, *The Strategic Use of Interests, Rights, and Power to Resolve Disputes*, 15 NEGOTIATION J. 31 (1999).

Given these facts, general managers in this situation would use advice from their attorneys coupled with their legal knowledge base to make a decision whether to litigate the case or settle. This decision reflects the fight (litigate) or flight (settle) responses that have evolved in humans over millions of years.¹⁴⁴ In deciding whether to pursue settlement, a decision tree and ADR, both of which were discussed previously at Part I.F., might be useful.

Managers would also benefit from a fundamental understanding of the difference between dispute resolution and deal making negotiations. They are likely to have experience with deal making negotiations, which tend to be forward looking and interest-based. Dispute resolution negotiations, on the other hand, look to the past and are more adversarial and position-based.¹⁴⁵ Because it is financially powerful and has a strong legal position if the case proceeds to trial, in this dispute resolution-type negotiation, Lessor has the ability to force Printer to accept a settlement on Lessor's terms. If Printer refuses to cooperate, Lessor's prospects of success in litigation are very good.

C. Step Three: Developing Strategies and Solutions to Prevent Future Legal Problems

The traditional fight or flight reaction to a legal concern explained in Step Two is the end of the story for most companies for the reasons discussed at Part I.F. For firms that decide to move beyond this step, Step Three represents the beginning of using the law for competitive advantage. Explained in Proactive Law terms, at this step they have an opportunity to become proactive by learning from Step Two experiences and developing preventive strategies and solutions.

Step Three emphasizes contract law and looks at the contract as a legal tool. While lawyers play an important role, this step is most effective when they work as a team with managers. For example, based on their litigation experience at Step Two, managers and attorneys at both Printer and Lessor may decide to review their contract terms and conditions and ensure that they are protected if similar conflicts arise in future contractual relationships. This requires a heavy emphasis on risk allocation and management and on contract clauses designed to protect them from a counterparty's breach of contract and from liability exposure resulting from their own breach of contract. The goal is a contract that is "final, binding and enforceable. The contract documents should, thus, be [legally] as 'perfect' as possible."¹⁴⁶

In attempting to achieve this goal, it is likely that managers and lawyers will pay special attention to five terms that, according to an IACCM survey, were the ones most frequently negotiated in 2007 business-to-business contracts. Because the approximately 800 companies that participated in the survey were from around the world, IACCM was able to analyze the results by different sources of law—for example, Uniform Commercial Code, common law, Germanic and other civil law systems, etc. The survey concluded that "the most notable point is how limited the differences [in the ranking of frequently negotiated terms] are . . ."¹⁴⁷ The top five negotiated terms were limitation of liability, indemnification, price and price changes,

¹⁴⁴ SIEDEL, *supra* note 2, at 6-7.

¹⁴⁵ See generally Frank E. A. Sander & Jeffrey Z. Rubin, *The Janus Quality of Negotiations: Dealmaking and Dispute Settlement*, 4 NEGOTIATION J. 109 (1988).

¹⁴⁶ Soile Pohjonen & Kerttuli Visuri, *Proactive Approach in Project Management and Contracting*, in A PROACTIVE APPROACH TO CONTRACTING AND LAW, *supra* note 91, at 75, 82.

¹⁴⁷ International Association for Contract and Commercial Management (IACCM), *The Top Ten Most Negotiated Terms in 2007*, <http://www.iaccm.com/articles/2008top10/> (last visited July 8, 2010).

intellectual property, and termination for cause or convenience. All terms but price relate directly to risk management.¹⁴⁸

In addition to reviewing their respective contract templates, the managers and attorneys might focus on ADR and on their bargaining strategy. Instead of using the reactive approach to litigation represented by Step Two, they can proactively use screens¹⁴⁹ to decide whether they want to include an ADR clause in their contracts and can then select an appropriate contract clause.¹⁵⁰ Managers can also work with legal counsel on their procurement and sales practices and negotiation strategies to ensure that their carefully designed risk allocation provisions are incorporated into all future contracts.

D. Step Four: Reframing Legal Concerns as Business Concerns and Opportunities

In his in-depth analysis of strategic contracting in this special issue, Professor Larry DiMatteo of the University of Florida notes a distinction between competitive advantage that is obtained at the other side's expense (which he calls "opportunism") and competitive advantage that is acquired through a more collaborative posture: "Often contracts can be designed to advance one party's competitive advantage at the expense of the other contracting party. At times the strategic design of the contract is a mutual undertaking."¹⁵¹ Step Three, with its emphasis on contract law and risk allocation, places more emphasis on opportunism while Step Four emphasizes collaboration.

While both steps are difficult to replicate (especially given the limited amount of time managers spend reflecting on their experiences),¹⁵² Step Four creates the penultimate competitive advantage opportunity because it taps into the promotive aspect of Proactive Law. It is at this step that managers and their legal counsel "go to the balcony" to gain a big picture perspective and determine whether their legal concerns can be reframed as business opportunities that they may not have seen before.

What might the balcony perspective reveal about contract law and the contracting process? In addition to increasing a firm's knowledge about its current contracting practices and the Contractual Literacy of its managers, this question raises opportunities along two dimensions. One dimension relates to the content of business contracts and the amount of detail they require, while the other relates to the negotiation philosophy that governs business contract negotiation.¹⁵³

¹⁴⁸ The results have been substantially confirmed annually in corresponding surveys undertaken by the IACCM, the most recent in December 2009–March 2010, to which more than 1,000 organizations contributed. See IACCM Contracting Excellence Special Edition 2010, Contract Negotiations As A Source of Value, http://www.iaccm.com/userfiles/file/CE_April2.pdf (last visited July 8, 2010) [hereinafter IACCM 2009 Survey Results].

¹⁴⁹ See *supra* text accompanying note 62-63.

¹⁵⁰ *Id.*

¹⁵¹ Larry A. DiMatteo, *Strategic Contracting: Contract Law as a Source of Competitive Advantage*, 47 AM. BUS. L.J. __ (2010).

¹⁵² See RUSSO & SCHOEMAKER, *supra* note 67, at 9.

¹⁵³ In addition to these two dimensions, other dimensions of corporate contracting capabilities may become visible that offer opportunities for improvement both in negotiated and non-negotiated contracts, online and offline. Beyond the contract content dimension, recent research has recognized dimensions related to the contracting process, along with relational and organizational dimensions. See Contracting Capabilities in Industrial Life-Cycle and Service

1. The Content of Business Contracts

The content dimension raises questions regarding the fundamental nature of a contract. In basic terms the definition of a business contract is a value creating agreement that is enforceable by law. Lawyers traditionally have focused on the enforceability component of a contract by framing it as a legal tool. This point of view dominates both the resolution of contractual disputes at Step Two and the preventive risk management measures developed at Step Three as lawyers attempt to construct what they consider to be airtight agreements that maximize their clients' legal rights and minimize legal risk.

The lawyers' orientation is not surprising given their training and mindset. Lawyers are trained to look at contracts through the eyes of a judge who might eventually have to rule on a contract dispute. As one law professor has noted, "the traditional approach in law schools is not to teach students how to make good contracts that facilitate business, but to focus on how to make good decisions in court. The education of lawyers does not prepare them for either business contracting or teamwork."¹⁵⁴ Lawyers traditionally have viewed a good contract as one that is enforceable in court¹⁵⁵ and they tend to rely on models and templates developed in past deals¹⁵⁶ rather than taking the clean slate approach used in business process reengineering.¹⁵⁷

While the "enforceable by law" part of the business contract definition is important and cannot be ignored, the perspective provided by a trip to the balcony reveals the need for balance with the "value creating agreement" part of the definition. In other words, while clients want their agreements to be enforceable, they also "want their contracts to achieve their business

Business, [http://yliopisto.joensuu.fi/oikeustieteet/siviili/CCC Research Report.pdf](http://yliopisto.joensuu.fi/oikeustieteet/siviili/CCC%20Research%20Report.pdf) (last visited July 9, 2010); Nari Lee, *From Tangibles to Intangibles – Contracting Capability for Intangible Innovation*, 21 U. JOENSUU PUBLICATIONS IN L. 33, 35-39 (2008) (discussing in context of commercializing intangibles), available at <http://ssrn.com/abstract=1350337>.

¹⁵⁴ Soili Nystén-Haarala, *Contract Law and Everyday Contracting*, in A PROACTIVE APPROACH, *supra* note 82, at 263, 264. See also George J. Siedel, *Legal Complexity in Cross-Border Subsidiary Management*, 36 TEX. INT'L L.J. 611, 614-15 (2001) (noting a fundamental difference between the case method in law schools and business schools and stating that business school students "are placed in the role of decision makers, in contrast to law students who focus on the analysis of decisions made by judges."). Northwestern Law School has been a leader in the United States in developing a new model of legal education. As Dean David Van Zandt notes:

[W]e are the only law school in the country that attempts to interview everyone who applies in order to assess their interpersonal and communication skills, as well as their fit in our community.... You [as a lawyer] must be able to function well on and lead teams as well as successfully manage projects. You must understand your client's strategy and what your client—whether an individual or an organization—is trying to accomplish with your help. Finally, you must be able to communicate both verbally and in written form not only with other lawyers but also with other teammates who bring their own expertise to the problem at hand.

Top-Law-Schools.com, Interview with Dean David E. Van Zandt of Northwestern University School of Law, <http://www.top-law-schools.com/van-zandt-interview.html> (last visited July 9, 2010).

¹⁵⁵ Haapio, *supra* note 140, at 160-61.

¹⁵⁶ Tobias Mahler & Jon Bing, *Contractual Risk Management in an ICT Context – Searching for a Possible Interface Between Legal Methods and Risk Analysis*, in A PROACTIVE APPROACH, *supra* note 82, at 339, 351.

¹⁵⁷ See MICHAEL HAMMER & JAMES CHAMPY, REENGINEERING THE CORPORATION: A MANIFESTO FOR BUSINESS REVOLUTION 218 (1993).

purpose . . . [which is] successful performance and on-going mutually rewarding relationships.”¹⁵⁸

This perspective changes the emphasis from *contract law* to a *contracting process*, where the contract becomes more of a management tool than a legal tool.¹⁵⁹ This mindset is consistent with changes in business practice over the past several years. At one time the dominant model in business was the sale of finished products¹⁶⁰ using “finished” contracts that provided clear specification of goods sold and clear delineation of rights and duties. In today’s world, the object of the contract – what is agreed upon – is becoming more indefinite and complex. For example, there has been a shift from readymade products to full-package services and life-cycle products.¹⁶¹ Contracting is far more complicated in networks that are created to produce new products and services.¹⁶² In this world, business relationships are governed less by traditional contracts and more “by the interdependence between the partners and the need for securing one’s own reputation.”¹⁶³ In this type of relationship, the partners operate within what University of Michigan Professor Robert Axelrod calls the “shadow of the future.”¹⁶⁴

The distinction between contract law and contracting has been emphasized by Northwestern University Professor Ian Macneil. Macneil recognized that as society becomes more complex, contractual relations have become more important than what is written in a contract. These relations are “characterized by long duration, flexibility and the tolerance of uncertainty.”¹⁶⁵ In their book on contracts, Macneil and Paul Gudel of California Western School of Law note that, “[o]nly lawyers and other trouble-oriented folk look on contracts primarily as a source of trouble and disputation, rather than a way of getting things done.”¹⁶⁶ In their opinion, contract law “is but a small part of contracts. You cannot begin to understand the law of contracts unless you also come to an understanding of contracts—what they are, how they work, why people enter into them and what people use them for.”¹⁶⁷

With the balcony view of the contract as a management tool that enables and guides value-creation and collaboration rather than merely a legal tool, managers (along with their attorneys) have an opportunity to develop specific strategies for competitive advantage. While some of these strategies might be industry-specific or transaction-specific, generic contracting strategies such as lean contracting should also be considered.

The lean contracting strategy applies lean production concepts to the “production” of contracts by asking whether company contracts can be simplified through an examination of the costs and benefits of various contract clauses. For example, attorneys in the law department at

¹⁵⁸ Haapio, *supra* note 140, at 161.

¹⁵⁹ *Id.* at 152-53 (discussing proactive contracting and commenting that, “[f]irst and foremost, it is about the conscious use of contracts and contracting processes as management tools which guide and support the success of the client’s business.”).

¹⁶⁰ See Vaala Haavisto, *Contracting in Networks, in A PROACTIVE APPROACH*, *supra* note 82, at 237, 247.

¹⁶¹ *Id.* at 244-45.

¹⁶² *See id.* at 247.

¹⁶³ *Id.* at 248.

¹⁶⁴ *Id.* at 248 (quoting ROBERT AXELROD, *THE EVOLUTION OF COOPERATION* (1984)).

¹⁶⁵ *Id.* at 243-44 (quoting Ian Macneil, *Contracts: Adjustment of Long-Term Economic Relations Under Classical, Neoclassical and Relational Contract Law*, 72 N.W. L. REV. 854 (1978)).

¹⁶⁶ Haapio, *supra* note 140, at 177 n.54 (quoting MACNEIL & GUDEL, *CONTRACTS: EXCHANGE TRANSACTIONS AND RELATIONS* (2001), at vii-viii).

¹⁶⁷ *Id.* at 165 n.32 (quoting MACNEIL & GUDEL, *supra* note 166, at 2).

the brewer Scottish & Newcastle sensed that company resources were being wasted in the contract negotiation process. Their work in developing what they called the Pathclearer approach to commercial contracting—and what we call lean contracting—provides a case study of the possibilities that arise when the contracting process is viewed from the balcony.¹⁶⁸ From their big-picture perspective these attorneys asked three fundamental questions.

First, what is the purpose of a contract? In answering this question, they developed a traditional definition of a legal contract. As explained in an article by Scottish corporate counsel Steven Weatherley:

[T]he only purpose of a contract [as contrasted with a non-contractual statement of business intent] . . . is to ensure that rights and obligations which the parties agree to can be enforced in court (or arbitration). Put even more bluntly, the essence of a contract is the ability to force someone else to do something they don't want to do, or to obtain compensation for their failure.¹⁶⁹

With this definition in mind, they realized that certain terms, such as price and product specifications, should always be captured in writing and that certain types of deals, such as “share purchases, loan agreements, and guarantees,”¹⁷⁰ require detailed written contracts. But from their balcony position, they also realized that many other scenarios, such as a long-term relationship between a customer and supplier, called for a “much lighter legal touch.”¹⁷¹ Realizing that in these situations the consequences of forcing contractual obligations on an unwilling partner—through “begrudging performance”¹⁷² or litigation—are not attractive, they concluded that leaving long-term relationships “to the irresistible forces of free market economics [is better than an] attempt to place continuing contractual obligations on each other.”¹⁷³ In other words, freedom of the market should dominate the traditional freedom of contract philosophy that has led to detailed written contracts.

Their second of the three fundamental questions is: “What are the drawbacks of detailed written contracts?”¹⁷⁴ In answering this question, the in-house attorneys reached a number of insightful conclusions. First, “[t]he apparent certainty and protection of a detailed written contract . . . [are] often illusory”¹⁷⁵ and wasteful as companies pay their lawyers first for drafting contracts that only the lawyers understand and second for interpreting what the contracts mean. The in-house attorneys witnessed “bizarre attempts” by lawyers attempting to reach certainty, such as “external lawyers spending hours drafting and debating the precise legal definition of

¹⁶⁸ Steven Weatherley, *Pathclearer: A More Commercial Approach to Drafting Commercial Contracts*, L. DEP'T Q., Oct.-Dec. 2005, at 39.

¹⁶⁹ *Id.* at 40.

¹⁷⁰ *Id.*

¹⁷¹ *Id.*

¹⁷² *Id.* at 41.

¹⁷³ *Id.*

¹⁷⁴ *Id.* at 42.

¹⁷⁵ *Id.*

beer for insertion in a simple beer supply agreement.”¹⁷⁶ They also recognized the futility of trying to predict the future.¹⁷⁷

Their second conclusion was that detailed contracts generate disputes rather than avoiding them. “Without a detailed contract, business people who become involved in a dispute will generally discuss the issue and reach a sensible agreement on how to resolve it. . . . However, where a detailed contract exists, the same parties will feel obliged to consult their lawyers.”¹⁷⁸ This brings to mind the Louis Brown premise that preventive law is based on predicting what people will do rather than on what a court will do.¹⁷⁹

Third, the complexity of such contracts causes confusion and the risk that the parties will be unable to focus on key terms because it becomes “difficult to see the wood for the trees.”¹⁸⁰

Fourth, the general law of contracts provides “a fair middle-ground solution to most issues” and “[t]he beauty of simply relying on the ‘general law,’ rather than trying to set out the commercial arrangement in full in a detailed written contract, is that there is no need to negotiate the non-key terms of a deal.”¹⁸¹

Fifth, negotiating detailed written contracts is expensive in terms of management and lawyer time and delayed business opportunities.¹⁸²

Finally, detailed written contracts can also focus the parties on worst-case scenarios that “can lead to the souring of relationships. . . . [C]ontinuing business relationships are like butterflies. They are subtle and hard to capture. When you do try to nail them down, you can kill them in the process.”¹⁸³

The third and final question is whether there are other ways to achieve business goals without detailed written contracts. The Scottish & Newcastle lawyers answered this question in the affirmative by focusing on the concept of “commercial affinity,” the force that keeps parties together in “mutually beneficial commercial relationships.”¹⁸⁴ The alignment of the parties’ interests through carefully constructed incentives, combined with the right of either side to walk away from the deal if it ceases to be economically attractive, incentivizes them to meet each others’ needs and alleviates the need for “a myriad of tactical rights and obligations in a contract.”¹⁸⁵

In summary, by going to the balcony, the Scottish & Newcastle attorneys realized that a different approach could be taken “when the parties are in a continuing business relationship, rather than just carrying out a snapshot transaction”¹⁸⁶ that might require a detailed written contract. They did not advocate a complete return to handshake agreements. For instance, “exit arrangements (such as obligations to buy dedicated assets from the supplier . . .) do need to be

¹⁷⁶ *Id.*

¹⁷⁷ *Id.* at 44.

¹⁷⁸ *Id.* at 42.

¹⁷⁹ See *supra* text accompanying note 94.

¹⁸⁰ Weatherley, *supra* note 168, at 43.

¹⁸¹ *Id.*

¹⁸² *Id.* at 44.

¹⁸³ *Id.*

¹⁸⁴ *Id.* at 45.

¹⁸⁵ *Id.*

¹⁸⁶ *Id.* at 40.

spelled out in the contract.”¹⁸⁷ But by addressing the three fundamental questions, they realized that much leaner contracts were possible.

The company’s Pathclearer approach in a continuing business relationship is illustrated by the lean contract that the company negotiated with a service provider. The two parties originally had a ten-year contract that ran over 200 pages. During contract renegotiation, they substantially reduced the size of the contract through the Pathclearer approach by giving each party the right to terminate after twelve months’ notice – a mutual “nuclear button.”¹⁸⁸ “By giving ourselves the ability to terminate at any time, we avoided the need to have to negotiate detailed terms in the contract. . . . This is a much more powerful way of influencing the service provider than a technical debate over whether they were complying with the words set out in the contract.”¹⁸⁹

Even when parties conclude that a detailed written contract is necessary, the view from the balcony might cause them to realize that there is opportunity for competitive advantage by eliminating certain provisions from their contracts that lead to inefficient contract negotiations. For example, Microsoft included a third party indemnity provision in its contracts that caused many contract negotiations to last an additional sixty to ninety days because customers did not like the clause.¹⁹⁰ Taking a big picture perspective of the clause, Microsoft softened the provision after realizing that it protected the company from a “phantom menace.”¹⁹¹

In other words, the benefits of the clause were minimal in contrast to potential costs that included reputational costs (resulting from confrontational negotiations), resource costs (attorney and management time) and cash flow costs (caused by delayed sales during the additional two to three months of contract negotiation). In the words of Tim Cummins, “[r]isk management is about balancing consequence and probability. Here is an example where consequence was managed without regard to probability—and as a result, other risks and exposures [such as reputational and resource costs] became inevitable.”¹⁹²

IACCM surveys of negotiation practices are especially useful in determining the benefit of risk management provisions. As noted previously,¹⁹³ an IACCM survey concluded that in 2007, four of the five most frequently negotiated contract provisions focused on risk management. The results were identical the following years in surveys of 2008 and 2009 negotiation practices, except that provisions relating to confidential information and data protection moved up to fifth place on the lists.¹⁹⁴ However, in the surveys of 2008 and 2009 practices, IACCM also asked whether the terms that receive the greatest focus in negotiation

¹⁸⁷ *Id.* at 45

¹⁸⁸ *Id.* at 41.

¹⁸⁹ *Id.*

¹⁹⁰ Cummins, *supra* note 139, at 138.

¹⁹¹ *Id.*

¹⁹² *Id.*

¹⁹³ See *supra* text accompanying note 148.

¹⁹⁴ For the IACCM 2008 survey results, see International Association for Contract and Commercial Management, The Top Negotiated Terms: Negotiators Admit They Are On Wrong Agenda, <http://www.iaccm.com/contractingexcellence.php?storyid=923> (last visited July 9, 2010) [hereinafter IACCM 2008 Survey Results]. For the IACCM 2009 survey results, see *supra* note 148.

result in optimization of business outcomes. Only one in four of the 2008 respondents and one in five of the 2009 respondents answered yes.¹⁹⁵

An IACCM commentary on these results echoes the analysis by the Scottish & Newcastle in-house lawyers:

It has become increasingly apparent that what we negotiate is out of step with business needs. This year, we have confirmed that many of the negotiators themselves believe they are negotiating the wrong things. . . . Specifically, the global economy has swung increasingly towards services. . . . The contract and the process through which it is created and managed become key instruments for relationship governance. Traditional contract standards and the focal areas for negotiation help little in providing such a framework. Liabilities, Indemnities, IP rights, Liquidated Damages are all topics that prepare for failure and disagreement.¹⁹⁶

2. The Negotiation of Business Contracts

In addition to the content dimension discussed in the previous section, the view of contract law from the balcony provides a big picture perspective of the negotiation process—that is, the strategy and tactics used in business contract negotiation. This perspective reveals that many organizations adopt a deal maker approach that separates contract formation from contract implementation. In the words of Danny Ertel writing in the *Harvard Business Review*, “An organization that embraces the deal maker approach . . . tends to structure its business development teams in a way that drives an ever growing stream of new deals. . . . But they also become detached from implementation and are likely to focus more on the agreement than on its business impact.”¹⁹⁷

Just as organizations adopt a deal maker mindset, individuals within an organization—the managers and attorneys who negotiate contracts—can slip into a deal maker mindset as their competitive instincts emerge during a negotiation.¹⁹⁸ These “negotiators act as if their main objective were to sign the deal.”¹⁹⁹ One of the consequences of this mindset is a focus on penalty clauses and risk management, as discussed in the previous section. Other consequences include the prevalence of positional bargaining tactics such as using surprise to gain advantage, holding back information, and setting false deadlines to close deals.²⁰⁰

These deal-making tactics might produce a contract that looks good on paper but that inhibits the relationships needed to successfully implement contracts. Given the ascendancy of business models that are built on relationships and what Macneil calls relational contracting,²⁰¹

¹⁹⁵ See IACCM 2008 Survey Results, *supra* note 194.

¹⁹⁶ *Id.*

¹⁹⁷ Danny Ertel, *Getting Past Yes: Negotiating as if Implementation Mattered*, HARV. BUS. REV., Nov. 2004, at 60, 62.

¹⁹⁸ See MAX H. BAZERMAN, JUDGMENT IN MANAGERIAL DECISION MAKING 150 (3rd ed. 1994) (stating that competitive instincts in negotiation are fueled by the mythical fixed pie assumption, a bias in human judgment that causes them to “assume that their interests necessarily and *directly* conflict with the other party’s interests.”).

¹⁹⁹ Ertel, *supra* note 197, at 62.

²⁰⁰ *Id.* at 65.

²⁰¹ See, e.g., MACNEIL & GUEDEL, *supra* note 166, at 11-25, 177-82.

managers and attorneys who can move from a deal-making to an implementation mindset have an opportunity to create competitive advantage for their companies by enabling the successful performance of their contracts. As Ertel notes, “[t]o be successful, negotiators must recognize that signing a contract is just the beginning of the process of creating value.”²⁰² Among the characteristics of the new mindset are a focus on the end of the deal, the identification of obstacles to successful completion, and a willingness to help the other side prepare for the negotiation, including consideration of implementation concerns.²⁰³

Problems often arise as a result of the parties’ unrecognized and unexpressed expectations—a concern that could be addressed with an implementation mindset. For instance, in the negotiations between Lessor and Printer described previously,²⁰⁴ Lessor and Printer could have helped each other by asking simple questions at the outset about the scope of the deal and functionalities and what more was needed (if anything) to reach the desired outcome. Identifying and aligning needs, establishing expectations and promises, and clarifying the actual scope of the offered solution (including what is included in the price and what is not) could have saved both parties a major business and legal problem.

An implementation mindset is consistent with the most recent IACCM survey of 2009 negotiation practices in which participants were asked to describe not only what they spend most time negotiating today, but also where they think negotiating time should be focused in the future.²⁰⁵ The following is a list of the terms that, according to the survey results, would be more productive in supporting successful relationships:

IACCM Top Ten Contract Terms That Would be
More Productive in Supporting Successful Relationships

1. Scope and Goals
2. Change Management
3. Communications and Reporting
4. Responsibilities of the Parties
5. Service Levels and Warranties
6. Price / Charge / Price Changes
7. Limitation of Liability
8. Delivery / Acceptance
9. Dispute Resolution
10. Indemnification

The top ten terms listed above are dominated by the need for clarity about the basic intentions of the parties and the need to ensure that the deal remains on track and can be adjusted in the face of changing conditions or requirements. With this revised focus, the parties can

²⁰² Ertel, *supra* note 197, at 62.

²⁰³ *Id.* at 63.

²⁰⁴ See *supra* text accompanying note 143.

²⁰⁵ IACCM 2009 Survey Results, *supra* note 148, at 4.

attempt to establish procedures for more open information flows and greater transparency, thus signaling their intent to collaborate and work together to manage risks and optimize results. As the 2008 IACCM survey concludes, “[t]erms such as liability and indemnities occupy the place they should—as last-resort fall-backs in the event that well-crafted intentions become derailed.”²⁰⁶

Another aspect of the implementation mindset relates to the evaluation of negotiation success. For example, rather than focusing on whether they achieved price discounts, purchasers should emphasize a full cost approach that considers matters such as “the operating efficiencies gained through using the supplier, the reductions in defects achieved by the supplier, and even the supplier’s role in developing product or service innovations.”²⁰⁷ And rather than focusing on sales volume, sellers should emphasize “the longevity of their customer relationships, the innovations that have resulted from their interactions with customers . . . and the referral business that can be traced to those customers.”²⁰⁸

Inefficiencies in the negotiation process might also become apparent from a balcony perspective. A Six Sigma methodology can clarify opportunities for improving the process. For example, in-house counsel at Becton, Dickinson and Company developed a process map showing steps in their negotiation process and used the map to measure the length of time to complete contract negotiations. An analysis of their data revealed opportunities for improvement, such as limiting “one off” communications by Becton Dickinson negotiators that weren’t shared with the negotiating team.²⁰⁹

Based on their analysis, the team made improvements in the negotiation process that produced “65 percent shorter negotiation periods. . . .”²¹⁰ The competitive advantage opportunities are obvious from the company’s conclusion that with this time reduction “a large company will quickly arrive at a productivity improvement equal to millions of dollars.”²¹¹ Beyond the savings in time and money, the Six Sigma project led to conclusions similar to those reached by the Scottish & Newcastle attorneys in discussing “commercial affinity”: “[I]f the agreement is for non-strategic software offered by many competitors, then the time spent on negotiating, revising and signing the agreement has not provided a useful result. This is because if the parties are unhappy with the arrangement in the future, the customer can simply hire an alternative vendor to provide the same thing.”²¹²

While this section has focused on deal making contract negotiations, dispute resolution negotiations can also benefit from a big picture perspective. Earlier in Part III, in examining the dispute between Printer and Lessor, we noted that dispute resolution negotiations tend to be adversarial and position-based in contrast to deal making negotiations, which are more forward-looking and interest-based.²¹³ We concluded at Step Two that, given its legal and financial power, Lessor could force Printer into an attractive settlement or easily prevail during litigation.

²⁰⁶ IACCM 2008 Survey Results, *supra* note 194.

²⁰⁷ Danny Ertel, *Turning Negotiation into a Corporate Capability*, HARV. BUS. REV., May-June 1999, at 55, 62.

²⁰⁸ *Id.*

²⁰⁹ Jason Mark Anderman, *The Future of Contracts Seen Through Six Sigma*, ASS’N CORP. COUNS. DOCKET, Sept. 2007, at 40, 44-45.

²¹⁰ *Id.* at 46.

²¹¹ *Id.*

²¹² *Id.* at 48.

²¹³ See *supra* Part III.B.

We also noted that at Step Three, the parties could take a preventive posture by strengthening their risk allocation contract provisions and bargaining hard to include those provisions in future contracts.

But what if Lessor, from the balcony, considers whether its dispute resolution negotiation with Printer could, instead, be transformed into a deal making negotiation. For example, the facts indicate that (1) Lessor is developing a new application program that has great financial potential but needs field development and (2) Printer has a solid reputation and a large customer base. It would seem that Printer would be an ideal joint venture partner for beta testing Lessor's new product.

By changing the emphasis from a positional, win-lose dispute-resolution negotiation that focuses on extracting damages from Printer in the event of breach through risk allocation provisions to an interest-based, deal-making negotiation that incentivizes the Printer to develop an outstanding product through the joint venture, the parties have an opportunity to increase the size of the pie in a manner that benefits both sides. By the same token, Lessor could bring this mindset to future deal-making negotiations with other partners, striving to use the negotiations to generate ongoing business opportunities rather than battling over risk allocation provisions.

IV. CONCLUSION

In Part I this article described the development and framework of a movement in the United States that focuses on the use of law for competitive advantage, using a four-part Manager's Legal Plan to illustrate how competitive advantage concepts can be translated into an action plan. Part II covered a parallel movement in Europe, the Proactive Law Movement, and the role it played in the development of a new stream of research and practice and in the adoption of a recent European Economic and Social Committee Opinion. Part III explored the intersection between the two movements and illustrated, through business contracting examples, the tremendous potential for value creation and innovation they offer for managers and lawyers alike.

To expand a medical analogy that was briefly mentioned earlier in this article,²¹⁴ the traditional management approach that is probably still dominant today (especially among the smaller, closely-held businesses that represent over 90% of businesses in the United States²¹⁵) is reactive in nature. That is, to most managers, lawyers serve an *ex post*, emergency room function. The medical analogy is a patient who goes to doctors for medical treatment after contracting malaria. This reactive approach is Step Two in the Manager's Legal Plan.

Step Three of the Manager's Legal Plan is similar to the preventive aspect of Proactive Law. The goal is to prevent legal harm through various measures such as risk allocation clauses in a contract. This is similar to someone using pills and netting to prevent malaria that is carried by mosquitoes.²¹⁶

Step Four of the Manager's Legal Plan brings into play the promotive aspect of Proactive Law. The goal here is to transform a legal concern into a business concern or even a business

²¹⁴ See *supra* Part II.A.

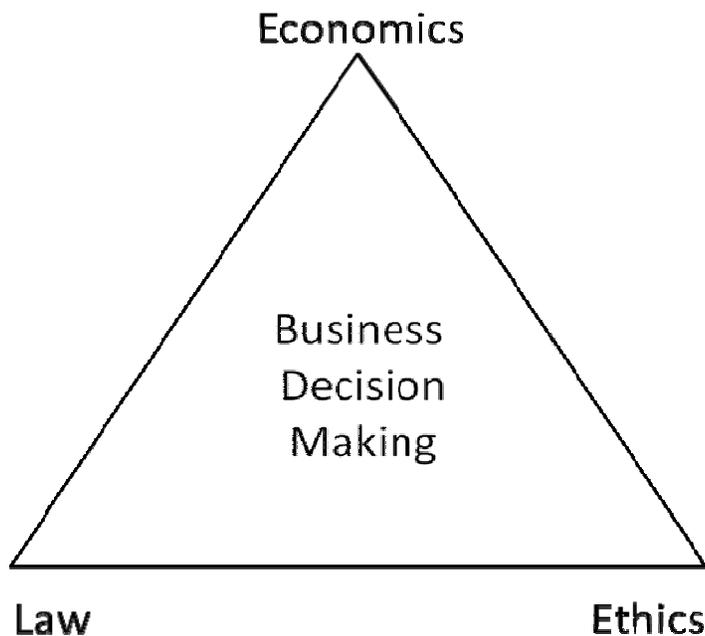
²¹⁵ eNotes, Closely Held Corporations, <http://www.enotes.com/biz-encyclopedia/closely-held-corporations> (last visited July 10, 2010).

²¹⁶ Haapio, *supra* note 82, at 25-26.

opportunity. By analogy, we might consider actions that could be taken in an area where malaria is prevalent. Instead of relying on netting and pills, the root cause of the problem could be addressed by eliminating mosquitoes through drainage of swamps, which might also produce additional health and economic benefits for the community.²¹⁷ By the same token, if contract negotiation could be moved away from an emphasis on the pills and netting of risk management, the overall economic environment and relationship between the parties stand to benefit.

Business decision making is based on the three elements depicted in Figure 4: economics, law, and ethics.²¹⁸ While business school education is dominated by economic decision making, law and ethics are also critical elements of any business decision and an essential element in the education of any business school graduate. The use of Proactive Law for competitive advantage highlights the linkage between economic, legal and ethical considerations.

Figure 4



This linkage is most evident in Step Four of the Manager's Legal Plan. At this step, when managers reframe legal concerns as business concerns and opportunities, they can see, for example, that a legal concern over product liability can be reframed as a business concern over developing safe products that meet customer needs. A legal concern over sexual harassment is reframed as a business concern over removing barriers such as abuse of power that prevent employees from meeting customers' needs. A legal concern over workers' compensation

²¹⁷ *Id.*

²¹⁸ See Timothy L. Fort, *How Relationality Shapes Business and Its Ethics*, 16 J. BUS. ETHICS 171, 177 (1997).

becomes a business concern about developing a productive workforce by encouraging safety at work and at home. This reframing can happen throughout the enterprise.²¹⁹

Through this reframing process managers can provide legal and ethical leadership that contributes to company success. This article previously referred to research by Professor Paine on company compliance strategies that are driven by lawyers and designed to prevent violation of criminal law.²²⁰ These strategies are minimalist in providing employees with ethical guidance. In the words of a former Chair of the Securities and Exchange Commission, “It is not an adequate ethical standard to aspire to get through the day without being indicted.”²²¹ For managers seeking higher goals—what Paine calls an “integrity strategy”²²²—proactive, law-based competitive advantage strategies enable companies to move toward economic success in an ethical manner.

²¹⁹ SIEDEL, *supra* note 2, at 167.

²²⁰ *See* Paine, *supra* note 50.

²²¹ *Id.* at 111.

²²² *Id.*