

Lawyers, Law Firms and the Stabilization of Transnational Business

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(28 Northwestern Journal of International Law and Business 489-525 (2008))

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Both are members of the Collaborative Research Center 597 “Transformations of the State” at Bremen University, Germany (www.sfb597.uni-bremen.de) where the research was carried out under the aegis of the “A4: New Forms of Legal Certainty in Globalized Exchange Processes” project. We are grateful to Prof. Dr. Stephan Leibfried, the Director of the CRC 597, and Prof. Dr. Graf-Peter Calliess, the Director of A4, for their generous financial and intellectual support. We also thank the Oñati International Institute for the Sociology of Law, Spain, where earlier versions of this research were presented in workshops. Both Eleni Skordaki and Avis Whyte gave assistance and advice for which we thank them. We thank the lawyers and law firms who helped us with our research. We are, however, especially grateful to Prof. Dr. Volkmar Gessner who insightfully guided us through the research as original Director of A4, as colleague, as mentor, and as friend.)

Abstract: Globalization is having profound effects on the practice and the organization of law. In the field of cross-border transactions the role of the state and its legal system has diminished such that private ordering through contracting is now the key mode of lawmaking. The vast majority of private ordering is undertaken by large law firms with international practices. Moreover, these law firms tend to adopt Anglo-American common law principles when putting together transactions. Yet within Europe there is competition from the law firms of the civil law countries, that have developed their own ways of international lawyering. But in order to understand the roles of lawyers in such cross-border transactions, we start from Abel and Lewis' question: what is that lawyers do? By using a number of case studies of transactions and disputes, we attempt to theorize how it is that lawyers create enabling and support structures for transnational business. We draw on Luhmann's ideas of stabilization of expectations and Gilson's depiction of lawyers as transaction cost engineers to help explain our findings.

1. Introduction

Cross-border business transactions are complex. But in this globalized age, as commentators such as Ohmae have argued,¹ business ought to be conducted simply despite national boundaries. Yet there are features of business that run counter to globalization and maintain a resolutely local character. A crucial aspect of this is the nature of law. No transaction can be carried out without a normative structure to provide a framework for the actors to operate within. Obligations, rights, warranties, covenants, and so on have to be specified and allocated. Even economists agree that the rule of law is essential for the conduct of business.² States, however, jealously guard their legal systems and resist incursions in their jurisdictions by others.³ No matter the level of "hyperlegality" states adopt, they will always be incapable of providing all the necessary support structures for cross-border business. Our thesis is that although states' legal systems are a basic necessary condition they are no longer a sufficient condition for transnational business and enterprise because a large part of states' work has been transferred to and commandeered by other institutions, most notably the internationally operating law firms.

We present this from the double perspective of Niklas Luhmann's ideas of the stabilization of normative expectations and Ronald Gilson's conception of the lawyer as transaction-cost engineer.⁴ While these two approaches appear to diverge, they actually reinforce each other and help us explain what it is that lawyers and law firms do in cross-border transactions.

We begin our paper with a discussion of our theoretical standpoint, which we follow with a survey of the corporate law firm detailing its structure and role in the modern economy which includes examples of the types of transactions that are handled by them. These are derived from fieldwork carried out by the authors in the UK and Germany.⁵ Finally, we attempt to reformulate our theory in the light of the empirical work and indicate where we consider further research should be carried out.

2. Theoretical Perspectives

Stabilizing Expectations Through Typified Solutions

The basic problem of any exchange lies in the insecurity which characterizes any interaction. Most institutional approaches view the problem of opportunism as the

central problem in any exchange situation. There is always the danger that parties will not behave in cooperative ways, because they prefer to do what renders the highest profit to them. Thus, mechanisms are necessary to develop stable expectations with regard to the behavior of interaction partners. According to Max Weber, only the state can provide stable expectations structures in modern economies.⁶ However, according to other institutional approaches like the empirical contract theory,⁷ institutional economics,⁸ relationship management⁹ or the network-approach,¹⁰ stable expectations with regard to the behavior of an exchange partner are developed on the basis on non-legal structures like networks or business relationships. Non-institutional approaches argue that the problem of cooperation cannot be reduced to the problem of opportunistic behavior. Interaction between two human beings involves the problem of double contingency: In order to coordinate interaction ego has to be able to expect the behavior of alter as well as the expectations alter has with regard to ego's behavior. It is therefore at the reflexive level of "expectations of expectations" that the problem of orientation of behavior, as well as the strategies for handling disappointments, has to be defined and solved. According to Niklas Luhmann, it is possible to react to disappointments in cognitive or normative ways. In the first case, expectations are adapted to reality when disappointed. In the second case, expectations are not adapted.¹¹ Luhmann even observed a clear prevalence of cognitive expectations in some global interaction fields like science and economy. However, even if cognitive expectations play a central role for the coordination of many transactions, it is most unlikely that exchange is possible without any normative expectations, which are among the concerns of this article.

Following Luhmann, the stabilization of normative expectations can occur at different levels: persons, roles and programs. While most of the current literature still supports Max Weber's thesis that the state legal system provides the central support structure in modern economies, the stabilization of behavioral expectations on the basis of general legal provisions (programs) is possible only if adequate legal structures exist, which is questionable in the international context. Consequently, the stabilization of normative expectations will be integrated at a lower level of abstraction; professional roles will have a particular significance, even when general programs seem to be at play.

Incompleteness and Weakness of Legal Systems in the International Context

National legal systems fail to work efficiently in many circumstances and many transactions are actually coordinated by non-legal structures. Still, in a national context actors usually have the possibility to resort to the state legal system in an endgame situation. This is completely different in the international context, where the development of a global legal system is unlikely at the present moment. The efforts of the nation states to create unified law are obvious, but the number of conventions that have been actually ratified by a sufficient number of nations in order to come into force remains small. Nevertheless, it would be a mistake to give up the legal approach too early. Shapiro assumes that a global commercial law can come into existence by the creation of a relatively uniform set of contract provisions.¹² Parties may also resort to arbitral tribunals or national courts to resolve their disputes. This approach is also supported by the enormous success of international law firms, which create complex contracts that work as a system of private government largely freestanding of any national jurisdiction.

But a closer analysis of the existing international legal structures reveals that this system is very weak and fragmentary, which is also supported by empirical findings showing that

the percentage of cases taken to court is considerably lower in the international context.¹³ The peculiarities of international transactions cannot be correctly taken into account by national courts, because national legal systems do not leave much scope for this. Existing legislation provides only the raw material for legal structures which has to be further developed and refined by judges and law professors. But we can observe a lack of case law in the international area and legal science focuses mainly on the national context. National legal systems have great difficulties in coping with new forms of coordination, like franchising, joint ventures or even supplier contracts. Existing legislation does not take into consideration the uncertainty of certain projects, the lack of concrete timetables, intense cooperation between the parties, mutual information and control rights as well as the economic dependence structure between the parties.¹⁴ Courts cannot provide expert knowledge in this area because disputes that arise out of long-term and complex contracts are rarely taken to court. Another major problem is posed by the practical difficulties in the enforcement of contractual claims which lead to a low level of effectiveness of the legal system in the international context. Most practical problems with international civil procedures are well known: parties are confronted with two legal systems; one party is always confronted with a foreign jurisdiction and a foreign language; cooperation between lawyers can pose major problems; costs are much higher; duration of proceedings, as well as time for preparation of the process are longer; superficial knowledge of the judge about foreign legal systems and international law lead to lower predictability of judgements, etc.

Studies on the coordination of transactions in international business show that many actors do not rely on legal structures.¹⁵ Instead, they coordinate their transactions based on relational structures, in which contracts play only a minor role for the realization of the transaction and the resolution of conflicts. Many transactions are also coordinated within networks of business relationships which guarantee a very high level of stabilization of expectations. The current discussion focuses on networks with a high level of institutionalization,¹⁶ ethnic networks,¹⁷ and illegal networks (e.g. Italian, Russian and Chinese mafias). But the transferability of this form of coordination to other types of associations has not succeeded yet. It is very likely that relational coordination structures will gain importance in an international context, because legal coordination structures are less effective there than in the national context.¹⁸ On the other hand, it is obvious that relational coordination structures cannot provide effective protection under all circumstances. Many transactions are carried out between unknown actors (spot market transactions), the establishment of long-term business relationships is often not possible or will not provide sufficient protection against opportunistic behavior because the value of the transaction is higher than the value of the entire relationship (risk transactions) or because actors have to make high specific investments at the beginning of a business relationship (long-term or complex-long-term transactions). Finally, a business relationship can break down, so that the relational mechanisms will not function in an endgame situation. As a consequence, it is possible to carry out many transactions without the support of legal structures, but global exchange altogether will not work without some degree of support of legal structures.

Stabilizing Expectations at the Level of the Law Firm

Because many companies have suffered negative experiences with cross-border litigation, there is a tendency among traders to consider the effectiveness of the legal system to be lower than it actually is. If international actors cooperate with lawyers to realize a transaction or to solve a conflict, the stabilization of expectations can occur only at the level of the role of the lawyer and not at the level of the legal system. Actors do not rely

on the state legal system as a last resort. They rely on the assumption that the lawyer who can make use of the international structures of his law firm will be able to provide adequate legal or non-legal solutions for any type of conflict that can arise out of the transaction. It makes no difference if the lawyer is involved at the beginning of the transactions or if he is only involved when a conflict arises because most large and mid-sized companies are usually repeat players. The assumption that the role of lawyers increases in significance when legal structures are more fragmentary is also supported by a simple comparison between the role of lawyers in civil-law and common-law countries.¹⁹ In the civil-law context we can find very well-developed legal structures at the level of the nation state, which means that lawyers largely work within these existing structures. In contrast, in the common-law context legal structures are not so well developed, which means that lawyers have to create their own structures. This leads to an increase of the importance of lawyers in comparison to civilian legal systems.

Luhmann defines the function of law as the stabilization of normative expectations through regulation of its temporal, social and material generalisation.²⁰ According to Luhmann, norms are counterfactually stabilized behavioral expectations. Their validity (*Geltung*) is independent of actual fulfilment. Norms fix a rather narrow section of the possible as achievable. Thus they are deceptive regarding the true complexity of the world and remain liable to disappointments. In order to create stabilized expectancy structures it is not only necessary to develop norms but also to provide mechanisms for the handling of disappointments. Apart from sanctions there are often other, functionally equivalent, strategies of counterfactual stabilization. In a highly complex and contingent world it is not possible to standardize (*normieren*) every single expectation. Social behavior requires achievements in reduction which facilitate reciprocal behavioral expectations. According to Luhmann, this occurs through temporal, social and material generalization. In the temporal dimension the structures of expectation can be stabilized by the development of explicit or implicit norms and the preparation of mechanisms for the handling of disappointments. These structures of expectation can be institutionalized within the social dimension, i.e., supported by the expected consensus of third parties. With increasing social complexity the co-expectation of third parties cannot be guaranteed any more. This leads to a differentiation between particular roles and procedures which have to decide about the law with binding effect for the whole of society. These roles can be taken over by judges or legislators. The structures of expectation can be fixed through identical meaning within the material dimension. This presumes a differentiation between four different levels of abstraction: persons, specific roles (lawyers, judges), specific programmes (norms) and values (fairness). The unity of an individual person serves as guarantee for a context of expectations particularly in intimate groups. A higher degree of abstraction can be achieved at the next level: the identification of a context of expectation upon the unity of a role-performer, which allows the disregarding of the individual-personal characteristics. In a complex world this supposes the institutionalization of roles, which occurs through normative co-expectation of third parties, which is oriented toward the role. A much higher degree of abstraction can be achieved if the context of expectation is based on programmes. Programmes are valid for a plurality of persons or roles, the degree of abstraction is variable, and programmes can be changed without persons or roles losing their identity. The sphere of values has a very indeterminate complexity with regard to permitted action and is therefore not suited for the generalization of behavioral expectations. The mechanisms of temporal, social and material generalisation are of heterogeneous kind. They generalize varied and inconsistent expectations. It is only after a certain period of

time that congruently generalized normative behavioral expectations are generated. Luhmann defines this phenomenon as the law of a social system.

Typified solutions represent explicitly formulated behavioral expectations. The stabilization of expectations in the temporal dimension requires the preparation of mechanisms for the handling of disappointments. Luhmann assumes that only sanctions can provide this function in the course of legal development. But the enforceability of sanctions in an atmosphere of low state legal certainty is limited. However, according to Luhmann it is still possible to maintain expectations regardless of factual enforcement, if the expectation is formulated under threat of a sanction and if parties are aware of the possibility of a sanction. Typified solutions can provide this function because they generate the appearance of a legal instrument. Typified solutions are formulated in a legal language: rights and obligations of the parties are supplemented by extensive warranties, delay, renegotiation, default and termination clauses. The appearance of enforceability is generated by the use of choice of law, jurisdiction, and arbitration clauses. Contracts symbolize legal structures. The symbolic function of contracts has already been described in another context by Suchman,²¹ and the work of Flood suggests a similar standpoint.²² Lawyers also simulate the proximity of the state legal system when they use typified solutions to resolve conflicts. The reference of a case to a lawyer is considered by parties as an essential step towards a legal solution, i.e., judicial enforcement cannot be completely excluded. From a legal perspective, amicable arrangements represent contracts as well. Typified conflict solutions are documented in a legal language.

For Luhmann, social generalization occurs through the differentiation of specific roles and procedures. In the area of typified solutions these roles can be taken by international business lawyers. Expectations are generated by the clients, but it is the lawyer who transforms these expectations into typified solutions. As a consequence, lawyers play a decisive role in the development of normative expectations. The procedure for the development of typified solutions is less formalized than a court procedure. Nevertheless, it is possible to identify a concrete structure: lawyers first compare and then combine different national typified solutions. In doing so, reference to the national legal systems has to be maintained. These references guarantee a high degree of acceptance of the typified solutions. Parties are involved in the process of the development of typified solutions, which ignites a learning process that makes it possible for the parties to accept the typified solutions. This occurs even though they may have had different solutions in mind when the process started. The development of unified typified solutions requires a high level of expert knowledge with regard to national typified solutions in different countries, as well as the particularities of international trade. Only large and medium sized law firms that provide an appropriate structure can develop typified solutions. The social validity of these typified solutions can be guaranteed through three factors: maintenance of a reference to national legal systems; a relatively uniform process of development of typified solutions; and a differentiation of specific roles for the development of typified solutions. As a result, we can assume that typified solutions can generate congruently generalized normative behavioral expectations as well, which will function autonomously in an atmosphere of low state legal certainty. Ultimately, these unified typified solutions represent a form of the new *lex mercatoria*.

Whereas Luhmann does not focus on the work of law firms it is necessary to resort to current law firm literature to describe the development and function of typified solutions in international law firm practice. Several approaches in current law firm literature

indicate that lawyers do not operate within an existing legal framework but that they provide much more complex structures to support (cross-border) transactions. Well-known concepts from this literature are those of creative lawyering²³, the concept of the lawyer as legal entrepreneur or legal engineer²⁴, the lawyer as manager of uncertainty²⁵, and the lawyer as transaction cost engineer²⁶. These structures may replace, simulate or integrate state legal structures. But the core elements of the support structures described by these authors are created by lawyers and not by the state.

Creating Value with Lawyers Through the Transaction

In this article we will use Gilson's approach to analyze where the creation of typified solutions takes place and what form they take. Gilson tells us where to look for the creative elements of business lawyers' work.²⁷ He takes as his starting point the transaction as framed by capital asset pricing theory. The theory states that risk-averse investors will always hold a diversified portfolio of capital assets".²⁸ The level of systematic risk will determine the asset's value and the market will function efficiently leaving no role for the business lawyer. Implicit in the theory are two assumptions that state there are no transaction costs and that all information is available without cost to all investors.²⁹ Since these assumptions, and the others that underlie capital asset pricing theory, cannot hold in the real world their failure provides the opportunity for the business lawyer to enter the transaction and create value instead of diminishing it. The lawyer creates a structure for the transaction that enables the parties to act as if the assumptions of the theory were accurate.³⁰ The lawyer becomes a transaction cost engineer. In taking a standard form acquisition agreement, Gilson illustrates the points at which the lawyer makes the most significant contributions. These are within the construction of the transaction agreement, especially representations, warranties, covenants, and conditions. These aspects concern timing of payments, earn-out structures, information procurement and so on, and are the points where the assumptions of the theory depart from reality. In addition to these internal elements, there are regulatory hurdles the parties may have to overcome, which will also include the tax issues in the agreement.³¹ Again, the lawyer's role is vital here. Much of this work is not primarily legal in a doctrinal sense, but works within the penumbra of the law. Indeed, Gilson reinforces the lawyer's role when he says,

The critical importance of transactional structure for purposes of regulation provides the core of an explanation for lawyers' domination of the role of transaction cost engineer. Because the lawyer must play an important role in designing the structure of the transaction in order to assure the desired regulatory treatment, economies of scope should cause the nonregulatory aspects of transactional structuring to gravitate to the lawyer as well.³²

Lawyers, for Gilson, are undertaking at the minimum two tasks. The first is designing the structure of the transaction so that it stages and paces the evolution of the transaction over a life course to completion. The second is to represent this structure in a set of documents that encapsulate the entirety of the actors' intentions and behaviors. At any point where breakdown occurs in the parties' future conduct, it is the structure as idealized by the documentation that will determine the potential outcomes. Thus lawyers have advantages over other professionals involved in the transaction such as investment bankers and accountants because lawyers possess the capacity to create typified solutions which do not rely on direct state intervention. The work of the lawyer has the significant symbolic role we mentioned above.

This is observable in the example of the takeover of the Safeway supermarket chain in the UK by another, Morrisons.³³ What started as a recommended takeover, one which both parties had agreed to, soon turned into a five-way battle as others scented the potential of the takeover. The lawyers with the investment bankers had initially arranged a consensual rapprochement between bidder and target, but since these transactions are publicized an opening is created for other bidders to make counter-offers, usually higher than the original.³⁴ When this occurs the target's board of directors can no longer support the first bid because of their fiduciary duty. Since the deal involved the UK's largest supermarket groups the Office of Fair Trading (OFT) insisted on submissions from each bidder on the competition (antitrust) concerns raised. These regulatory issues had the potential to derail the deal, thus the lawyers had to craft their OFT submissions carefully. Three of the bidders would have acquired a market share of more than 25 per cent and were therefore blocked by the regulator from bidding. After dropouts and blocks the original parties remained in play. The lawyers constructed a scheme of arrangement which involved the target's share capital being cancelled and replaced by that of the bidder.³⁵ Because the takeover moved from being a straightforward takeover to that of a scheme of arrangement, the regulatory rules changed also. Under takeover rules the Takeover Code of the Takeover Panel determines the parties' timetable. A scheme moves the action from the Takeover Panel to a court which approves the scheme. Using a scheme avoids large tax liabilities such as stamp duty (transfer tax) on share transfers. The lawyers' roles were to construct a series of typified solutions that created a symbolic order that harmonized regulatory structures, including tax, with the parties' expectations for the new business. Because of external interferences their role was amplified as further regulatory and financial issues came to the fore. Timelines were extended from a matter of a few months under the recommended takeover to a year and three months under the contested situation. It was the lawyers' expertise in these different but concurrent areas that permitted the takeover to proceed: they acted proactively in creating structures and reactively in dealing with the exigencies of the regulatory frameworks.

These are the two complementary elements of our theory. The first is demand for stability of expectations aroused in the parties to the transaction, which is achieved through the production of typified solutions. And the second is the deployment of the expertise of transaction cost engineering by the lawyer in the course of the transaction that ultimately creates value within typified solutions thus meeting the parties' expectations.

3. The Structures, Contexts, and Role of Law Firms³⁶

Corporate law firms have dominated the field of international business law. The range of law firms we include in this study range from medium-sized firms in Germany and Spain to large law firms in the UK and the US. Despite their differences in size, e.g., Clifford Chance numbers over 3,000 lawyers worldwide but many mid-range firms number around 250 or more lawyers, the essence of the work undertaken varies little. There are of course significant differences in scale and scope, but the forms are similar.

The majority of law firms are formed by partnership and are typically flat-profiled organizations composed of partners and associates. Others may be run as franchises or as more hierarchical and autocratic structures. Some law firms can trace their histories for hundreds of years, e.g., Freshfields became solicitors to the Bank of England in 1743.³⁷ But some countries, such as Greece, have only allowed the formation of law firms since

the 1990s; and in other countries like England and Wales parts of the legal profession, e.g., barristers, prohibit the creation of law firm partnerships.³⁸

Law firms come in many shapes and sizes from small upwards, in the late 20th century. In particular in the US and the UK the legal profession was marked by the growth of corporate large law firms that measure their lawyers in the thousands and have scores of offices around the world. While they are primarily an Anglo-American phenomenon, large law firms have taken root elsewhere in the world. Today several European firms number over 500 lawyers. But it is difficult to compare the growth of US and UK firms to the development of law firms in Continental Europe because most European firms have remained relatively small until the 1990s. For example, in Germany the largest “law firms” have traditionally been the in-house counsel of large companies (e.g. Deutsche Bank with 100 lawyers, Siemens with 75 lawyers, Volkswagen with 30 lawyers, and Bayer with 24 lawyers)³⁹. The current situation in Europe indicates that European law firms have not simply copied the American model, but that they have developed different strategies to corporate lawyering in the national as well as the international context.

Roots

No definitive start date can be assigned to law firms, but historians have found records of partnerships existing, for example, such as two or three-man partnerships, in England in 1780. The great majority of lawyers, however, were solo practitioners. Industrialization was one of the main incentives to the development of law practice in both the US and Europe. Landed gentry began to exploit their latent natural resources, which brought lawyers into the business of creating businesses and raising finance for them. Big enterprises, like the formation of the railroads, demanded an array of legal skills in finance, corporate structures, and bankruptcy, which lawyers were able to offer.

The spirit of enterprise was fostered by permissive and facilitative legislation such as the British Joint Stock Companies Act of 1856 and the Limited Liability Act of 1855. Regulation was limited and fraud rife. The City of London became a hive of inventive activity as investment trusts were born and foreign bonds issued.⁴⁰ As railways extended their lines, law firms were involved in forming companies, acquiring land, petitioning Parliament, and resolving contract disputes. For example, the London firm of Norton Rose maintained 23 railway company accounts between 1848 and 1878. These law firms had small numbers of partners, two or three were the norm. But they were buttressed by large numbers of managing clerks, unqualified men, at ratios of partners to clerks of between 1:20 to 1:100. The railway business gave lawyers considerable experience in risk management, investment strategy and trust administration, both domestically and abroad.⁴¹

However, 19th century New York City is the true birthplace of the modern law firm. Both legal education and law firms transformed themselves to become meritocratic and rational institutions based on scientific principles, with law schools adopting the case method devised by Christopher Columbus Langdell at Harvard, and Paul D. Cravath evolving his law firm organically by selecting partners from the finest associates trained within the firm.⁴²

As law firms changed from small, parochial partnerships into large, complex, diverse organizations, mirroring the growth of economies, the expression “law factory” materialized and tensions within the profession opened up so that Julius Henry Cohen, for example, published a small book in 1916 titled *Law: Business or Profession?*⁴³ Law firm

histories show New York law firms growing rapidly. Sullivan & Cromwell had over 200 lawyers by the 1930s, causing Karl Llewellyn to caution us about law factories mopping up all the best lawyers leaving too few to do the remaining “law jobs” in society.⁴⁴ The expansion of the imperial world brought with it international development for law firms as demonstrated by John Foster Dulles of Sullivan & Cromwell. He played a key role in the negotiations of the Versailles Treaty at the end of the First World War and his firm subsequently helped capital flow from North America to Europe, especially to Germany aiding the National Socialist government.⁴⁵

In the period since the Second World War, however, not only have the numbers of lawyers grown significantly but the numbers of large law firms have expanded along with the size of these firms. The most dynamic growth has taken place in the large law firm sector, while small law firms, though containing the largest number of lawyers, have declined in strength as the changing economics of practice militate against them.

Context

In England and Wales in 2006, the Law Society estimated that there were around 8,900 law firms with 27 per cent of them based in London. Eighty-seven per cent of all law firms have four or fewer partners. Within this 46 per cent of firms were solo practitioners. Firms with 26+ partners (1.3 per cent of the whole), however, are increasing in number and 60 per cent of these are located in London. And mega-law firms which accommodate 20 per cent of all practising lawyers are virtually all London-based. There were also 155 multi-national practices in England and Wales.⁴⁶

The American Bar Association data for 2000 tell us there are over 1 million lawyers of whom 75 per cent practice in 47,563 law firms in the United States. Firms with 1 to 5 lawyers comprise 76 per cent of all law firms, while firms with 20+ lawyers comprise 24 per cent (101+ lawyer firms are 14 per cent). While the number of law firms has increased—in 1980 there were 38,500 and in 1991 there were 42,500—the rise has been at the expense of the smaller firms, which in 1981 were 81 per cent of the population.⁴⁷

The UK and the US have shown similar trends in the year on year decline in the overall numbers of smaller law firms. Small firms are shrinking in number while larger firms are growing in size if not so much in quantity. When these movements are linked with the trend of increasing numbers of applicants to the legal profession each year, this suggests that there is consolidation of law firms occurring. The biggest growth has been in large law firms: there are a substantial number of law firms with over 1,000 lawyers. But even the largest law firms are tiny compared to the large accounting firms such as PricewaterhouseCoopers which has over 146,000 professionals on staff worldwide in 766 offices in 150 countries.⁴⁸

The statistics for lawyers across Europe show wildly divergent numbers. For example, Germany has about 116,000 lawyers; France over 40,000; Italy 140,000; and Belgium 12,600 lawyers, which seems to indicate that population size is not a reliable indicator of the numbers of lawyers. Moreover, in these countries the typical law firm is small as, for example, France shows with the average number of lawyers in a law firm being 2.73. There are occasional large law firms like NautaDutilh of Amsterdam with 500 lawyers. Beyond Europe statistics are scant but in a country such as China there are 110,000 lawyers with more than 10,000 domestic law firms and around 160 international law firms with offices in China.

The US and UK Perspective: Law Firm Growth, Tournaments, Mergers and Clients

It is clear that law firms in the US and UK have grown in size and appear to possess a dynamic for growth. A number of causes have been adduced to explain this growth. Galanter and Palay argue that there is a tournament at the heart of law firms which provides the reason.⁴⁹ Law firm partners are endowed with capital. The best way to exploit their capital is to hire associates who will share in it and expand the work base. This is known as leveraging and creates profit for the partners. However, only a proportion of those associates can be promoted to partner, in order to maintain the partner-associate ratios, so they engage in a tournament to discover which ones will succeed. Those who become partners will have invested heavily in the firm and hence will be committed to staying. This is close to the Cravath model outlined above. The law firm therefore contains its own engine of growth and soon becomes identified with exponential growth.

The model has attracted critics. Some say growth rates among law firms are too varied to be explained by a single model. Moreover, many law firms are introducing more layers between associate and partner, such as “salaried partner” or “nonequity partner”, thereby extending the tenure track.⁵⁰ Other suggestions propose that firms have incentives to become “one-stop shops” for their clients, cross-selling services across a number of areas so clients rely on single firms for all legal work. Another is law firms grow by offering a large array of services to a large range of clients to avoid becoming dependent on a single client or a particular type of work. To this extent the Anglo-American large law firm model is becoming more pyramidal with a shrinking equity partnership.⁵¹

Many law firms have grown through mergers. In some cases these are marriages of equals and in others they are effectively takeovers. One of the key mergers that sparked a rush to merge among law firms was that between Clifford-Turner and Coward Chance in the late 1980s: the corporate and banking firms were galvanized by the deregulation of financial services, the “Big Bang”, in London in the mid-1980s.⁵² The result grew into the UK’s largest law firm, Clifford Chance. In the 1990s Clifford Chance then undertook a three-way merger with Pünder Volhard of Frankfurt and Rogers & Wells of New York producing one of the world’s biggest law firms. The other big global law firm, Baker & McKenzie, took a different route. It started in the late 1940s in Chicago with the intention of becoming a firm with global reach.⁵³ The process was to acquire lawyers in each target country to form a firm that was a partnership within the local jurisdiction but also a part of an international partnership. Over a period of 50 years Baker & McKenzie achieved what Clifford Chance attained in fifteen by aggressive mergers and acquisitions.

While the rise of the large law firm has been on the basis of a full-service provision one other law firm should be considered in this context, namely, Skadden Arps of New York. In its early years the firm was largely Jewish and because of the discrimination against Jews in the US, Skadden was consigned to mainly marginal legal work.⁵⁴ During the 1960s and 70s Skadden earned a reputation for aggressive lawyering in hostile mergers and acquisitions (M&A), such work being shunned by the mainstream law firms. From this basis Skadden was able to evolve from being merely an M&A law firm to a full-service one. The firm became renowned for engaging in high-profile transactions such as the \$25 billion leveraged buyout of RJR Nabisco by the private equity firm Kohlberg Kravis Roberts.⁵⁵

Perhaps the significant feature of the emergence of law firms like Skadden Arps and Wachtell Lipton, another Jewish M&A firm, was the manner in which they altered the structure of lawyer-client relationships. Until the 1980s corporate client relationships with their legal counsellors were of longstanding duration. Some of the relationships between law firms and investment banks go back more than a hundred years, based on social as well as economic links. Because of the highly-sought after skills that a firm like Skadden possessed in proxy fights, any corporation enmeshed in a hostile takeover would not be able to rely on the abilities of their normal law firm. It simply would not possess that experience. The corporation would attempt to retain Joe Flom of Skadden or Marty Lipton of Wachtell, the key players in the field. Thus notice was served on longstanding lawyer-client relationships in favor of transactional relationships. Two other changes reinforced this alteration in style. Corporations took more of their legal work in house and corporate legal counsel became more selective about which law firm they chose, tightly monitoring budgets and bills. Law firms ceased to be the stable structures they traditionally had hitherto been. Instead of partners remaining with the same firm throughout their careers, they began to move from firm to firm seeking greater advantages, taking their clients with them.

Nowadays, the corporate field is largely dominated by large firms. The large firms were the only ones that had the capacities to expand their work to the international context. In contrast, the role of midsized and smaller firms in the area of corporate and international work remained small in the Anglo-American context.

The European Perspective: “Americanization” of the Legal Market or Development of a European Approach to Corporate and International Lawyering?

While the English and American law firms have aggressively moved into countries like Germany and merged with local law firms or established their own offices with German lawyers, the Anglo-Saxon model has met with resistance from European firms.⁵⁶ The German market has gone through tremendous changes in the last 15 years, but it would be wrong to characterize this development as the “Americanization” of the legal market that has been proclaimed by authors like Shapiro or Trubek. A closer look reveals that UK and US firms only exercise a dominant position in specific areas.

Germany is the most important economy in continental Europe and one of the leading export nations world-wide: however--similar to other continental European countries--law firms are still relatively small. Only 12 firms have more than 200 lawyers. Another ten firms have more than 100 lawyers. The presence of UK and US firms varies at different levels of the legal market. At the level of large firms that advise multinational and large national companies US and UK firms have taken over an important position: five of the ten largest firms are from the US or UK (Clifford Chance, 373 lawyers; Linklaters, 343 lawyers; Lovells, 286 lawyers; Taylor Wessing, 267 lawyers; White & Case, 249 lawyers). Most of these firms merged with a German firm to expand their global reach: Clifford Chance has merged with Pünder; Lovell & White with Boesebeck Droste⁵⁷ and Linklaters with Oppenhoff⁵⁸. All these mergers were not made on equal terms. Some of these firms have created alliances before they decided to transform into a single firm. Oppenhoff and Linklaters were part of Linklaters & Alliance⁵⁹ before they decided to merge in 2001⁶⁰.

On the other hand, the largest firm in the German market, Freshfields Bruckhaus Deringer (572 lawyers), has resulted from the first merger between a UK and a German

firm on equal terms. About 50 per cent of its partners are German. The second largest German firm in the German market, CMS Hasche Sigle (436 lawyers), has established a successful best-friends network, which comprises nine top European firms⁶¹. The rest of the top 12 are “traditional”--German firms with a very strong focus on the German market (Beiten Burkhardt; Luther; Nörr Stiefenhofer Lutz; Hengeler Mueller; Gleiss Lutz). Some of these firms have created “best-friend relationships”: examples include the alliances between Gleiss Lutz, Herbert Smith (UK), Stibbe (Benelux), and Cuatrecasas (Spain); as well as Hengeler Müller, Davis, Polk & Wardwell (US), Slaughter and May (UK) and Uría & Menéndez (Spain). Thus, the top-level in the German legal market is not dominated by a specific type of law firm (UK or US based big law firm), rather it can be characterized as a mix of different types of firms.

A comparison of some key figures between top German and top UK firms shows surprising results. Firms like Hengeler Mueller; Gleiss Lutz and Nörr Stiefenhofer Lutz, some of the most exclusive firms in the German market, are much smaller than the top UK firms with regard to size and turnover. However, all these firms have a profit per equity partner (PEP) of over £500,000 (Hengeler: £582,800; Gleiss Lutz: £633,000; Nörr: £515,580). The PEP is smaller than that of large UK firms (e.g. Clifford Chance, £810,000; Freshfields, £830,000), but partners in UK firms usually have more associates in their teams than German firms. Consequently, it can be assumed that the profitability of these firms is comparable to the profitability of large UK firms.

A look at the next level of law firms shows a completely different picture. There are 10 firms with 100 to 200 lawyers (among them six UK or US firms). The rest of the top 60 has between 40 to 98 lawyers. In this group we also find UK or US firms that have opened smaller offices in Germany (DLA Piper, 87 lawyers; Jones Day, 67 lawyers; Cleary Gottlieb Steen & Hamilton, 60 lawyers), but the vast majority are “traditional” German firms. Many of these firms have grown through mergers between different local firms and their offices often operate as largely independent units. These firms are the central advisers for midsized companies.

One explanation for the fact that we cannot observe a clear Americanization of the German market is based on cultural attitudes which resist being subsumed under Anglo-American managerial structures that appear far removed from the collegial practice of law. This explains, why many of the larger midsized firms in Germany have refused to merge with US or UK firms. In addition, these firms have a very high standing in the German market and they have no desire to become a junior partner in an international alliance. Other central aspects are related to more practical problems that result from the specific characteristics of the German economy. First of all, Germany, as well as the US, has a very strong local economy. Midsized companies traditionally play a very important role for the German economy and most of these firms operate cross-border. In addition, Germany is a federal state with numerous important business centres all over the country. Frankfurt, Hamburg, and Munich are the most important legal markets. Berlin still plays a crucial role as the federal capital, even though several large firms have closed their offices here in recent years. However, economic centres are located all over the country. Consequently, cities like Stuttgart, Düsseldorf, Köln, Hannover, Bremen, Dresden, Leipzig have become major legal markets as well.

The Hannover area (capital of the state of Lower Saxony) is a good example for this development. This area has a strong automotive sector with Volkswagen, the fifth largest car manufacturer in the world, at its centre. Numerous large and midsized suppliers are

located in the region. Some of these companies, like Continental, have opened foreign factories all over the world and have become multinational players themselves. Hannover is also one of the most important locations in the German insurance sector (HDI Gerling; Hannover Rück; Talanx), and the most important location in Europe for industrial fairs (CEBIT, Hannover Industrie Messe). The legal market is largely controlled by mid-sized firms with very strong links to regional politics and economy. The leading firm in this area has approximately 90 lawyers nationwide and less than 30 lawyers in the Hannover office. Nevertheless, international work is part of the daily routine of the firm. Another traditional firm in the region, Suhren Peltzer Meinecke (fifth in the region), with less than 20 lawyers has advised regional mid-sized companies and banks for more than 30 years. In the last seven years its new managing partner, a former associate from Taylor Wessing, has developed a strong international practice in the area of German-Spanish and German-Chinese commerce. Most of the firm's clients remain mid-sized companies. Yet the firm also works for several large foreign firms, among them top 100 Chinese companies, as well as Spanish and Chinese export insurance companies. Obviously, very large and complex deals in this region, e.g. the acquisition of VDO, a former Siemens company, by Continental worth approximately €11 billion, are carried out by large firms that are located outside the Hannover region. The regional firms cannot provide the resources to carry out deals of this size. Nevertheless, the vast majority of cross-border transactions is carried out by large mid-sized firms and boutique firms specialized in international commerce.

Even in very important legal markets like Frankfurt, which is the most important financial market in Germany, we can observe the continuing influence of mid-sized firms and the establishment of many smaller law firms with high levels of specialization (boutiques). Some firms have developed a high level of specialization in specific areas of law. Others have specialized in bilateral practice. Examples are Dolce & Lauda (German-Italian business) and Schiller (German-Spanish business). Some of these firms have started to position themselves in the European market.

Lawyers Knowledge, Networks and Legal Skills

US law firms are, at bottom, supported by a large domestic law market.⁶² Going global for them is dependent on the sustained development of their original markets. The success of firms like Cravath and Wachtell Lipton exemplifies the policy of primarily concentrating on their home markets and using networks of overseas law firms to build their international practices.⁶³ UK firms have never had the luxury of a big domestic market and therefore sought work outside the UK. The empire provided a conduit into profitable regions such as the Middle East and Asia. Globalization has resulted in shifting polarities with regions like the European Union, the North American Free Trade Area and Asia representing the bulk of foreign direct investment (FDI) flows in the world. In addition to the transactions that result from this FDI, non-state disputing regimes have emerged, including those based with the World Trade Organization and the World Bank.

One advantage traditionally enjoyed by American firms is their long ties with investment bank clients.⁶⁴ The major investment banks that engage in the key capital markets deals are all American, e.g., Goldman Sachs, Morgan Stanley, and Merrill Lynch. We know from law firm histories that these ties may go back more than 100 hundred years. And strangely, though the lawyer-client relationship has undergone something of a change in recent years from one-stop shop to transactional relations, some of these particular ties have endured.

While some firms have been able to rely on these traditional ties, the changes in the business landscape brought about by mergers and acquisitions, restructurings and so forth, have made lawyer-client relations more tentative. In house counsel are stricter about legal budgets, asking law firms to commit to beauty parades to obtain work.⁶⁵ Law firms have to market themselves forcefully and enlist the aid of the state in opening international legal markets for them.

There is intense competition among law firms for international or transnational work. Law firms actively promote *their* country's law as the best vehicle for business transactions. The area of capital markets work displays this clearly. The main sources of finance in the international arena are the US (New York) and the UK (London).⁶⁶ Thus most transactions would be undertaken either in New York State law or English law or a hybrid form of both. Increasingly global transactions involve numbers of different jurisdictions and each must be incorporated into a form that enables either New York or English law to coordinate the range. Acting globally while thinking locally is reasonable as long as law firms are not overly constrained by local culture.

The crucial question for large continental European law firms is to what extent are international law firms merely exporting (imposing) English or New York law as opposed to engaging in the practice of local law? The large law firm's core alliance is with the Anglo-American nexus. It therefore has to create ways to tie in local norms to the overarching pattern devised in English and American law. Finding ways of dovetailing sometimes incommensurable systems has led to the globalization of legal education and training. Young lawyers from large firms outside the Anglo-American nexus find it essential to take an LLM degree at a major American or English law school, otherwise they will not be conversant with global legal techniques.⁶⁷ Reinforcement for this view is found within the intergovernmental organizations such as the World Bank which usually insist on their lawyers possessing a master's degree.

The situation for international mid-sized and boutique firms is somewhat different. As mentioned before, the domestic market in Germany in the area of mid-sized business is very large. Consequently, global activities of most mid-sized firms are often based on their domestic work. Mid-sized companies will usually not ask their law firms to participate in "beauty parades" but they have started to cooperate with different firms in different areas of law. This has led to greater competition in the market and the development of stronger specializations in this field. Today, many larger mid-sized firms still consider themselves as general-practice firms but at the same time they put a strong emphasis on the development of core competencies in specific areas of law, in particular international law which is the fastest growing area of work for mid-sized firms.

International transactions carried out by mid-sized firms, like real estate projects, supplier contracts, or joint ventures, are obviously less complex and involve smaller amounts than the transactions supported by larger firms. Some areas of work of big law firms are strongly linked to specific business or finance centers like New York or London, which explains why most transactions in this area are carried out under New York or English law. In contrast, key players involved in transactions carried out by mid-sized firms are not always found in these particular locations, which makes it much more important to adapt the legal service to the legal, cultural, and social particularities. Many standard contracts used in this context have been developed in the US or UK (joint venture,

franchising, etc.). Nevertheless, these contracts have to be adapted to local specialities and the function of the contract depends strongly on the context in which it is used.

The structures developed by firms to operate in the international context and the quality of their work varies strongly among different mid-sized firms. Some firms have no or little experience with international transactions and they will also communicate this to the client and not take up an international mandate. However, many mid-sized firms that do not have any experience at the international level will also try to keep their clients and falsely represent to have international competence and experience.

Due to the relatively small size of mid-sized firms it is almost impossible for these firms to develop a general expertise in international work. Most firms will have to specialize in particular areas of law or particular countries. Competence and experience in different areas of international law will usually not be attributed to the law firm but to specific lawyers in the firm. Because of the high relevance of context-factors it is essential for lawyers to be knowledgeable about foreign laws, rules and practices of particular foreign jurisdictions. In addition, interaction in an international context will pose major problems if the lawyer is not aware of cultural and social differences and different negotiation styles.⁶⁸ The ability to “bridge the cultural gap” is an necessary prerequisite for this type of work⁶⁹. Thus, a firm that works in German-Spanish business will probably not recruit somebody with an LL.M. from a top American university but rather recruit lawyers with work experience and an LL.M. from Spain or even Spanish lawyers. This is the only way for these firms to bridge gaps between different legal systems.⁷⁰ Even if the work of mid-sized firms is more standardized than the work of big law firms creative lawyering skills⁷¹ are of crucial importance to develop new legal argumentation and to create new flexible solutions. The interrelatedness between legal and non-legal fields also makes it necessary to provide knowledge in different non-legal fields.⁷²

The central problem for medium sized law firms is their organization in the international sphere. While most large law firms opened offices in different countries or established long-standing relationships with foreign large law firms, medium sized law firms lack the financial capacity to expand abroad. The creation of networks between independent law firms has been one possible answer to this problem. But most authors believe that some of these networks are just paper entities, “designed to look good on the letterheads”.⁷³ If the networks are large, it will be difficult to evaluate the quality of a foreign law firm.⁷⁴ A law firm will take a high risk if it has to carry out an important deal for a major client and is forced to cooperate with an unknown law firm in another country that is part of a large network. As a consequence, mid-sized law firms try to build smaller networks with a high social density. The networks are often limited to a few members, because otherwise it is not possible to establish frequent and intense contact between the firms. Thus, it can be assumed that personal networks with lawyers and other key players are of higher importance than in the area of large firms because office networks or formal alliances do not exist.

The influence of the Anglo-American way of lawyering in the European market at the level of mid-sized and boutique law firms is probably smaller than at the top level. The letterheads of the larger mid-sized firms and boutique firms show that these firms have recruited associates with international education and work experience. But most of these firms have been involved in cross-border work for decades, they have strong links to other key players in the field, and they have developed their own ways of international lawyering.

In the next section we present a series of case studies of cross-border transactions involving large and medium sized firms. The first is the sale of an office building owned by a Japanese consortium in London to a company based in the British Virgin Islands, the second is the sale of a large African mobile telephone company to a Middle Eastern telecoms company, the third is the promotion of a construction project by a German company in Spain, and the fourth is litigation between automobile companies in Spain and Germany. All the cases have cross-border elements and make extensive demands on the lawyers' knowledge and network relationships. Despite how well-resourced are the lawyers own knowledge banks, they must possess the capacity to know when—in terms of risk management and deal structure—it is necessary to avail themselves of the expertise of other lawyers outside their own jurisdiction. As the case studies show, this is easier for some than others.

4. Case Studies

(i) Selling a London office building

The transaction involved a large office building, which was fully leased, in the City of London worth £220 million. The building was being sold by the UK nominee of a joint venture of Japanese banks who were selling off their portfolio of European property assets. The purchaser was a former UK public limited property company (plc) that went private and moved offshore to the Caribbean, referred to as “XX”. It is considered to be one of the most sophisticated players in the property market dealing in hedging and property derivatives. The purchase was being funded by another syndicate of Japanese banks.

The purchase was a joint venture between XX and an Australian pension fund. XX wanted the deal done in a combination of English, as the lead, British Virgin Islands (BVI), Australian, Jersey, and Japanese law. The lawyer for XX took the lead in drafting the documentation used. Initially he expected the transaction to take around several weeks, but the complexity of it combined, especially because of tax difficulties, with the respective needs of local laws meant that ultimately it took six months to complete.

Not all of the local laws played significant parts. To make the joint venture work BVI law was used to set up a special purpose vehicle to hold the assets of the transaction. For XX this was easily done for it undertook between 20 and 30 large property transactions a year, which has resulted in good relationships between XX and the BVI regulators. Jersey was where the bank accounts would be located; again offshore.

The key element in these types of transactions is minimising the tax burdens that arise. Since XX is offshore, it is protected from the UK Revenue and Customs although not always. The transaction was expected to take around four weeks to complete, but as the lead UK lawyer noted,

For various tax reasons we had to go through five or six different structures because they weren't working. The problem was that for the Inland Revenue, tax domicile is a question of *fact*. Although XX is offshore in the BVI where 'management and control' are based, it also has a large office in central London, which clouds the issue. All my emails to XX *had* to appear to go to the BVI even though a number of important decisions were being made in the London office.

The email trail had to be kept clear and direct so the Inland Revenue wouldn't query anything.

XX used a big BVI law firm, which also had an office in London, for its transactions which acted for both borrowers and lenders by setting up a 'Chinese Wall' in the firm. This is quite common in these classes of transactions. The lead UK lawyer also said that despite the number of different types of law involved, whoever was the originator in drafting the document retained ultimate control over it: "the bits that relate to the overseas element of the transaction are just slotted into the standard form of the agreement." He went on to say that there were two areas where he asked the overseas lawyers to check carefully because each jurisdiction would treat them differently and they were important in the UK, namely, issues of financial assistance and inherent defects (e.g., insolvency, preferences) because in large part foreign counsel were content to "sit back and allow the English counsel do it, but they must look at them because they aren't described in the English document." The insolvency provisions were important because there was a special purpose vehicle involved which must not be affected by any insolvency of the parent company.

The trick for the lead lawyer was to have a local lawyer write an opinion letter that would help co-ordinate the divergences so that the problems appeared resolved, or write a section of the agreement so it could be incorporated. For example, with the Australian pension fund there were a number of issues surrounding superannuation funds and the lead lawyer used the pension fund's own law firm to provide the necessary wording. Another example concerns the requirements of the UK Land Registry on signatures on release documents. Since the vendors were Japanese, a Japanese *bengoshi* had to write a short opinion, which eventually ran to three pages, on the validity of the two Japanese signatures. And for dealing with the bank accounts being moved from the UK to Jersey, a local firm was used to set them up.

The lead lawyer found he had difficulties with time differences. Dealing with the BVI meant a difference of only five or six hours which was acceptable. With Australia a time difference of 10 hours, he was compelled to make phone calls at 10 or 11pm. Being stretched between the time zones of BVI and Australia was physically tiring.

Finally, there was the role of the banks in the construction of the loan agreement. They are intimately involved because they provide the financing for the transaction. "Banks are pretty good because what they do is provide a transaction or document person, and often its someone who spent three or four years in Allen and Overy. Some banks don't use lawyers, they use people in the back office who have a good feel for it. And they can provide a better service than lawyers, because there aren't many areas in a loan agreement where you're going to be breaking the law, so of more significance is the commercial deal you get. These people have a list of all the transactions that have gone wrong and the reasons why and they are much more focused and have a better view of the documents. On the borrowers' side, it really depends on the client. Some are professional, others...well...who knows..." The lawyer emphasized this point by unpacking the role of the transaction lawyer as one who primarily concentrates on the deal, yet may do many of them for particular clients. He put it this way:

There's a problem for transaction lawyers around risk management. Transactions *are* individual items, but if you do a series of them for the same client, then do you become an adviser as well? How much do you have to recall about past deals? I always send an

email to the client near the end of the deal to say that you must check these representations to ensure everything is covered. There is a strong possibility that the client's lawyers could be held to know about things and so not be able to state, "Oh, that was just a single deal."

Although the transaction took considerably longer than originally anticipated—months rather than weeks—the crux of the matter was the difficulty surrounding the tax issues. Gilson noted that this was an essential element of transaction engineering.

(ii) Selling a company

This transaction involved selling an African mobile phone company with 5 million subscribers to one of the Middle East's largest telecoms company (ME). ME was using this foray to make a stake as a global telecoms player. The key lawyers were English law firms. ME approached their lawyer's firm at one of the Middle Eastern offices. ME's law firm was a "Magic Circle" law firm as was the vendor's.⁷⁵ In this case the African company asked an investment bank to run a controlled auction. The bank sent letters, according to ME's lawyer, "to anyone they could think of who might be interested in buying this business. Any mobile operator, any telecoms company, and private equity houses as well." Around 100 companies were approached with a rough outline of the deal. If they were interested, they would be sent a confidentiality agreement. Out of those contacted a smaller subset expressed interest and signed the confidentiality agreement. They then received an information memorandum, a book of several hundred pages, describing in detail the company, its share structures and its financial information. The book was put together by the financial advisers and lawyers. Because the business is telecoms, there were many regulatory hurdles to overcome. This meant even the vendors would organise a due diligence exercise. In addition, the vendors would provide, through their lawyers, the initial documentation. They would ask for some comments, but not too many. On this basis the potential bidders could decide what they were to bid for and how much it might be worth.

The next stage was for the sellers to select, out of a field of 10 to 20, four who would submit binding offers. This would go to a final stage where two bidders would negotiate the final terms. The final sale price was \$3.4 billion. There is always a possibility that this kind of deal can turn sour and fail to complete. In part this is due to the complexity of the funding arrangements required to be in place for this size of transaction to go through. These transactions usually involve leverage, i.e. other people's money or debt, and therefore all types of guarantees have to be arrayed, default conditions prepared for, and more. This particular transaction was being funded by loans from four banks in the Middle East, the UK, Switzerland, and the US. If the sale were to fail, the vendor's lawyers were running a parallel track with the sale to place an initial public offering in the market. The hope was that it would be redundant.

Although the operations were based in Africa the selling company was headquartered in the Netherlands. No African country had the scale or sophistication in its legal market to handle such a large transaction. However, some local African law firms were used during the due diligence process to monitor regulatory matters. Local contracts would be investigated by the UK lawyers on the basis that the content would be the issue not the law and that the content would be too complex for local lawyers. Moreover, as English lawyers were used, they naturally used English law. But as the lawyer remarked, "We need a lingua franca and that's English law. But actually what the governing law of say a share acquisition agreement is doesn't really matter that much. Because most of it is the

terms which tend to be pretty well identical, especially the commercial terms, whether it's English, Dutch, French, German or Italian law.” In this transaction, even though there were 16 operating subsidiaries, what was actually bought was a single block of shares in a Dutch company. The share purchase agreement was done under English law while various minor ancillary elements, such as the transfer documents because they were Dutch shares, had to be done under Dutch law. The lawyer said that usually share purchase agreements would be done under local law, but this was an exception because although the company was Dutch, the business was pan-African and there were more than 100 shareholders who came from a variety of locations. And the purchasers came from different places, so English law provided a common site. In this respect the variety of laws in play were significant as far as the regulatory issues were concerned but to the overall structure of the transaction they were relatively insignificant.

The transaction therefore was a combination of relatively simple company law issues, complex regulatory matters, and complicated financing and tax issues. The lawyers' tasks were to bring these together into a set of coherent structures which enabled the parties to complete their transactions under a range of headings that included private and state concerns. It helped that the lawyers from the different law firms were used to working with each other and that they were used to working with the investment banks. The enduring institutional relationships and networks were a vital key to the success of the transaction.

(iii) Investing in foreign construction projects

This case involves a project promoted by a German construction firm, which involved the construction of three apartment parks in Mallorca. The German construction firm cooperated with a German bank which was in charge of the sale of the apartments. This bank had long-standing ties with the firm and it recommended the law firm to the construction company. Because of the sensitivity of this type of work, reputation is considered a crucial factor in the construction business. The only way to get this type of work, which is very lucrative for a midsized law firm, is through recommendation of other construction firms or banks which are doing these projects.

Typically the construction company, which has no or only little experience in the Spanish market, expects a wide range of services from its law firm which includes legal and non-legal aspects. The first part of the work was the formation of a new corporate entity, which incorporated legal, tax, and non-legal issues such as evaluating the trustworthiness of the Spanish company. In the project, the law firm developed a specific corporate structure which consisted of the foundation of a Spanish limited company, which would be responsible for the construction work and sale of the apartments, and also a German GmbH & Co. KG (limited company and a company limited partnership) to promote sales in Germany. This solution guaranteed limited liability in Spain (legal issue), a relatively low taxation burden (tax issue) and high acceptance on the Spanish market, which facilitated the cooperation with construction firms and banks (economic and relational issues). The company also had long-standing business relationships with local accounting firms.

The law firm helped the construction company to purchase land and it participated in the negotiations with the seller. When a dispute arose with the owner because of a mortgage on the property which had to be paid out, the firm sent a lawyer from its Barcelona office to settle the case with the owner. In this situation the law firm was able to use its bi-national structure, which consisted of the availability of lawyers in different locations,

who are able to solve conflicts by taking the particularities of the situation as well as social and cultural differences of the parties into account. The firm analyzed existing building law in Mallorca, established contact with the local administration, resolved insurance issues, and participated in negotiations with a German bank for the financing of the project. It checked the creditworthiness of the construction firms, drafted and controlled construction and architecture contracts. In addition, it handled all private sales contracts with final customers. The sale of apartments often involves the handling of small and large conflicts with final customers due to technical defects, desired extra changes to plans, etc. The firm sent one of its Barcelona lawyers to Mallorca to control the construction work. He also spent about 70 per cent of his time handling customers' complaints which made it possible to settle all conflicts on the spot.

The firm had extensive experience of this type of work and enjoyed high standing in the construction business because it offered this full-range service. Although the project was embedded in a legal structure consisting of many different contracts, the client tried to avoid any type of judicial confrontation with other partners because judicial procedures would have endangered the realization of the project. Consequently, the main task of the law firm was not to enforce contractual claims in court, but to find extra-legal solutions to conflicts. A major part of the firm's work consisted of preventative actions, like the detailed analysis of the solvency and the reputation of possible partners for its clients.

(iv) Suing across borders

The weakness of the legal system at the international level significantly limits the scope for litigation in cross-border conflicts. As a consequence, law firms have to evaluate the costs and risks of litigation and other forms of dispute resolution, which are almost impossible to conduct without prior experience in this field. Litigation is usually not an appropriate solution when small amounts are at stake,⁷⁶ because the costs will often exceed the benefits.

By contrast, in complex transactions the amounts at stake are usually very high, but lawyers avoid state courts because their capacity to handle conflicts that arise in such situations is poor. Here the lawyers were planning to pursue arbitration if settlement became impossible since that offered the potential for a rational result.

Nevertheless, litigation is a common tool for mid-sized law firms to solve cross-border conflicts. The following case involves a contract between a Spanish supplier (S) in the automotive industry and a German supplier (G). S claimed from G the amount of €117,000 for the delivery of screws for the automotive industry. G refused to pay the contract price arguing that it had a counter-claim in the amount of approximately €130,000 against S resulting from a prior delivery. The screws sent in the prior delivery suffered from a brittle fracturing that was produced from the induction of hydrogen. The defective screws had to be removed from motors that were already delivered to a large car manufacturer.

The central technical problem of the conflict between the parties involved the question whether the brittle fracturing was the result of a deficient heat treatment or whether the danger of brittle fracturing was unavoidable due to the particular material, coating, and strength that was ordered by G. The German lawyers for S asked expert opinions from a German and a Spanish specialist. However, the experts from different countries provided different results.

The case also involved several problems related to international and foreign law. If the parties do not select the applicable law the Convention on the International Sales of Goods (CISG) applies in the particular case. However, the general conditions of G's contract contained a clause in which the application of the CISG was excluded. One of the central points of discussion was the question whether G's general conditions were integrated into the contract or not. Even if this was a standard problem in cross-border conflicts, there was not much case-law on this topic, which made it necessary for the lawyers to develop new legal arguments. In addition, the case involved several questions related to Spanish law.

The situation in this case, which is very typical for commercial conflicts, lead to a shift of responsibility from the state towards the private parties involved in the litigation process. The court did not have the time or capacity to handle international cases. In addition, it had to ask for several expert opinions with regard to the technical as well as the legal problems involved in the case. However, this can also lead to difficulties, because the quality of the experts often varies. In addition, only few institutions in Germany are able to provide expert opinions on questions of foreign law and the involvement of an expert usually costs additional time. In contrast, the law firms involved have the necessary resources to deal with these problems. The legal arguments provided by lawyers are much more extensive than in national litigation. Even very simple problems of international private law and international civil procedure are discussed in detail, because most lawyers assume that judges do not have a lot of knowledge in this area and will not be able to invest enough time to examine all relevant legal aspects.

Time constraints also played a crucial role in this case. First of all, the taking of evidence would be very cost and time extensive. In addition, it was almost certain that the defeated party would appeal the judgement, which meant that a final result would not be obtained for at least two years.

The parties were able to settle the case in the first hearing within 10 minutes. The judge summarized the facts of the case and presented a preliminary evaluation of the case, which involved short statements with regard to the burden of proof and a risk analysis. The parties agreed that G had to pay an amount of €70,000 to S.

The lawyer is not working independently from the state legal system because he is within the shadow of the law. But the role of the state is decreasing because it could not provide an adequate solution for the parties. The role of the state in this situation was limited to the creation of a fear of possible sanctions for both parties which created an important incentive to settle the case⁷⁷. Nevertheless, the extensive legal and technical argumentation prepared by the lawyers provided the central basis for the settlement. The detailed discussion of legal and technical problems made it possible to point out the central risks for both parties.

The success of a settlement in these types of commercial conflicts depends crucially on the lawyer's ability to present an overview of all legal and non-legal aspects of the conflict and to integrate them into the discussion process. The solution appears to be a legal solution because it is created by lawyers. But in reality it involved legal and technical aspects of the case, a risk analysis, as well as the economic factors. However, the appearance of a legal solution is necessary for the parties to accept the settlement.

In many situations the lawyers will even have to create completely new legal structures for the handling of new types of problems which have never appeared before. This occurred when the present case took a different turn. The German law firm was told to sue the Spanish lawyer in the case for professional negligence. In contrast to national contexts, there is no case law on liability of lawyers in cross-border litigation in most European countries.⁷⁸ In addition, it was unlikely that a Spanish judge would have the resources and competence to handle the case diligently. The level of unpredictability of court decisions is very high because the law only exists as *raw material* so that the stabilization of expectations at the level of the legal system is virtually unattainable.⁷⁹ In such situations it is essential to consider the case law of other countries and to develop the legal fundamentals of lawyer liability in the international context on this basis, which did not exist in Spain. The client would be reliant on his law firm, which would have to assume the role of the judge to develop new case law. This is delicate and time-consuming work that requires intense research and legal creativity. At the same time, a high level of sensitivity is needed, in order to avoid offending the judge, which could lead to the dismissal of the suit. The high importance which is attributed to the person of a particular lawyer is displayed by the client's desire to have a particular lawyer from the law firm. This was the head of the Spanish department of the law firm with whom he shared a long-standing personal relationship and who had advised his company in other matters.

This case is also a good example of the intense cooperation between international medium sized law firms which is not feasible without prior experience. Lawyers from the different offices kept in close contact and their responsibilities were strictly defined. The law firm established a team of four lawyers (two from one of the German offices and two from the Spanish offices) to handle the case. The Spanish lawyers were in charge of the court procedures and the German lawyers prepared the facts of the case and corresponded with the client. The main creative part of the work was carried out by the German lawyers who collected case law on lawyer liability from different countries and tried to develop a general jurisprudence which could be presented to the Spanish judge. The Spanish lawyers were in charge of adapting the general theory to the Spanish context within existing Spanish case-law on lawyer liability in domestic cases which was almost non-existent.

5. Conclusion

Our case studies show that lawyers strive to stabilize clients' expectations at the level of the law firm. Leakages from this level to that of the state system are tantamount to an admission of failure on the part of the lawyer. Judges, courts and other state tribunals are by their nature unpredictable. Points of law are wild cards that can turn any way. The key to successful transactions is to retain their conduct within the system of private ordering through the construction of enabling structures. Private ordering necessarily operates within the shadow of the law and courts, but those shadows must never be permitted to darken these relations.

Lawyers' work connects across a number of areas including legal, relationships, networks, knowledge, and national boundaries. Its purpose is to create enabling structures that facilitate the construction of transactions. At this level there is almost parity between the work of the law firm and that of the state. The role of enabling structures can be perceived to compensate for the wildness of the market. The state endows the law firm to act on its behalf where it has neither the competence nor the reach when transactions straddle national boundaries.⁸⁰ Thus legitimacy is assured.

Scale is important. There is a distinction between the roles of the large law firms and the midsized firms. The resources available to the large law firms are vast. They have large numbers of lawyers in offices in the main commercial and financial centers of the world. Even if they have not internationalized in this manner, their established networks of best friends enable them to operate in a functionally similar manner. Large law firms are intimately connected to the major investment banks, other professional service firms, and the credit rating agencies. Sophisticated clients are aware of these resources and expect to capitalize on them when they hire these law firms.

Clients know, in many situations, large law firms will provide stable solutions based on the well-known and accepted principles of Anglo-American law. And in cases where clients have the power to force the selection of alternative legal systems (e.g. oil and gas contracts in Russia), they are able to generate structures that limit the damage potential of these choices. Even where such choices are forced upon parties, other aspects of the transaction, especially financing, will of necessity involve the selection of different jurisdictions which has the capability of diluting the exclusivity of the host system.

Large law firms dominate because they are powerful institutions that collaborate in the production of the many elements that combine to make transactions possible. The vast majority of transactions are based on types of standard documentation. Some is produced directly by law firms, the experience of past deals. Others arise from participating in the production of documents by international associations. The International Swaps and Derivatives Association (ISDA) produces a series of master agreements and protocols, which are constantly updated, that are the bedrock for all such deals. Law firms and banks actively participate in the ISDA to ensure that the documentation meets the needs of their clients.⁸¹ This accounts for the translation competence of lawyers as they bring the world of mundane transactions into a more rarefied legal discourse and structure.⁸² It is the equivalent of de-contextualizing idiomatic legal wording to construct a transcendental core.⁸³ Ultimately it creates a path dependency which is difficult to avoid.

Midsized law firms have fewer resources available to them compared to large law firms. Their cross-border reach is frequently bi-national which limits their capabilities to clients. They have to rely more strongly on associations, linkages, networks, and affiliations to attract a greater range of cross-border work. Co-optation by the large Anglo-American law firms is a constant threat and one which these types of firms within continental Europe are resisting. Consequently, their clients are smaller businesses and companies than those of the large law firms.⁸⁴ This means the level of transactions carried out by medium-sized firms is of a different nature than that of the large firms. However, similar to the field of large firms we can observe a shift of responsibility from the state to private actors. The lawyers become transaction cost managers, who decide on the use and combination of different mixes to solve cross-border conflicts or to realize international transactions. Legal and non-legal instruments are not used alternatively, they are combined.

Luhmann's work directs us to the role of stabilizing expectations by creating typified solutions that work in many contexts. These are created by law firms especially in situations where the state is weak. In doing this law firms reduce the transaction costs to clients by minimizing such costs that accrue through tax burdens and regulation thereby creating value in the transactions, according to Gilson. In the case of conflicts, lawyers

exercise their influence to create alternative solutions that do not leave the sphere of influence of private actors. These structures, embedded in the documentation enable the life course of the transaction to assume a predictable trajectory accessible to all the parties. Lawyers and law firms tame the naked power of the market by assessing and managing risk delivering to clients predictable and calculable outcomes. Despite Weber's claims that only the state was capable of delivering stable expectations structures in capitalist economies, we have demonstrated that modernity requires more sophisticated solutions that derive from institutions outside the state that have effectively pierced the state's monopoly on norm production.

A fundamental question put by Abel and Lewis in their study of lawyers was what is that lawyers actually do?⁸⁵ We believe we are showing the kinds of roles lawyers adopt and the types of activities they engage in. Future research must take account of not only the organizational aspects of lawyers and professional service firms but also their work. For ultimately it is their work that defines them and gives them their identity.

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⁷⁹ McBarnet *supra* note 59.

⁸⁰ This assumes, perhaps, mistakenly that both law firms and states act rationally. This assumption is questionable given what we know about the structure of law firms and states. To perceive them as connected and unified in purpose fails to accord with reality, which is that these institutions are at best a series of Montesquieu structures, to borrow Lazega's term, that is interlocking but independent niches in competition for scarce resources. See Emmanuel Lazega, *The Collegial Phenomenon: The Social Mechanisms of Cooperation Among Peers in a Corporate Law Partnership* (2001).

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