

Introduction

1.1 INTRODUCTION TO THE BOOK

Is legal knowledge valuable? For businesspeople, legal knowledge has been an essential part of their craft for a very long time. The earliest known contract was written on a cuneiform tablet in 2750 BCE,¹ where a farmer drafted into the military of King Sargon I contracted with another farm to grow and secure his crops in his absence in exchange for half of the grown produce.² Contracts involving sales and purchases, rentals, labor contracts, co-partnerships and other agreements were used as early as 2000 BCE.³ Centuries later, the Roman Empire had formally trained legal experts who advised on legacies, guardianships, and contracts.⁴ In the modern era, prominent seventeenth-century merchant Gerard de Malynes noted that a businessperson was not a “compleat merchaunt” without knowledge of commercial law.⁵ Legal knowledge was so important to Joseph Wharton that, when he established the first collegiate school of business at the University of Pennsylvania in 1881, business law was one of five subjects he specified for the curriculum for what is today one of the most respected business schools in the world.⁶

¹ Willis D. Morgan, *The History and Economics of Suretyship*, 12 CORNELL L. REV. 153, 153 (1927). The contract also imposed a suretyship, whereby a merchant acted “as a surety for the lessee, guaranteed the performance of this contract by him.” *Id.*

² *Id.*

³ Paul Halsall, *Ancient History Sourcebook: A Collection of Contracts from Mesopotamia, c. 2300–428 BCE*, FORDHAM UNIV. (Mar. 11, 2024), <https://sourcebooks.fordham.edu/ancient/mesopotamia-contracts.asp>.

⁴ Charles P. Sherman, *The Study of Law in Roman Law Schools*, 17 YALE L.J. 499, 500–01 (1908).

⁵ See, e.g., Nathan Isaacs, *The Merchant and His Law*, 23 J. POL. ECON. 529, 553 (1915). For a further exploration of Malynes’s thinking, see, e.g., E.A.J. Johnson, *Gerard De Malynes and the Theory of Foreign Exchanges*, 23 AM. ECON. REV. 441 (1933).

⁶ George J. Siedel III, *An Executive Appraisal of the Importance of Business Law*, 22 AM. BUS. L.J. 249, 263 (1984). See also UNIV. OF PENNSYLVANIA, THE WHARTON SCHOOL, <https://www.wharton.upenn.edu/>.

Today, legal knowledge is an essential part of any modern organization. Most firms retain legal counsel in charge of managing any legal issues that the company may encounter. While some firms may have a single attorney on staff, larger organizations such as Citigroup and General Electric have over 1,000 trained lawyers on their payroll.⁷ These attorneys earn every penny of their salaries. When a Chief Legal Officer (CLO) is one of the five highest-paid executives, and thus considered one of the most valuable executives in the entire firm, the company experiences an increase of 1 percent in supernormal returns⁸ and an increase of 3.5 percent in supernormal returns when the firm is subject to a legal shock such as a securities class action lawsuit.⁹ Such valuable CLOs are also associated with better information transparency, improved earnings forecasts, and lower risk stock price crashes.¹⁰ When CLOs ascend to become CEO, firms' stock liquidity improves, lower incidents of insider trading appear, and markets have less dramatic responses to earning announcements.¹¹ When the top lawyer in the firm is also the top executive in the firm, the value of legal knowledge she possesses reduces incidence of corporate litigation by up to 74 percent.¹²

Legal knowledge is valuable to more than company lawyers. Compliance and other nonlawyer professionals play a critical role in ensuring that firm policies and practices align with the legal obligations of the enterprise. Managers who hire and supervise employees must comprehend a wide range of employment and labor laws. Executives who authorize contracts must not only understand what they are signing but also appreciate the legal implications if one or both parties do not fulfill their obligations. Firms with significant intellectual property rights need lawyers and managers who can ensure patents, copyrights, and trademarks remain un infringed. Such managers also need to know how to avoid inadvertent and potentially costly infringement of the intellectual property rights of others. The notion that "law is too important to be left to the lawyers"¹³ is particularly true in the organizational space,

⁷ See Rees Morrison, *The Largest Law Departments among U.S. Companies in the Fortune 500*, GENERAL COUNSEL METRICS (Feb. 16, 2012), <https://www.lawdepartmentmanagementblog.com/the-largest-law-departments-among-us-companies-in-the-fortune-500/>.

⁸ A supernormal return is a payoff on an investment that is greater than the typical market rate of return.

⁹ Robert C. Bird, Paul Borochin, & John D. Knopf, *The Role of the Chief Legal Officer in Corporate Governance*, 34 J. CORP. FIN. 1, 2 (2015). The return that was measured is known as a buy-and-hold abnormal return, which is a valuable metric for measuring a firm's performance against similar competitors over time. *Id.*

¹⁰ See Robert C. Bird, *Business Law: Now More Than Ever*, 39 J. LEGAL STUD. EDUC. 167, 176–78 (2022) (summarizing studies).

¹¹ *Id.*

¹² M. Todd Henderson, *Do Lawyers Make Better CEOs Than MBAs?*, HARV. BUS. REV. (Oct. 30, 2017), <https://hbr.org/2017/08/do-lawyers-make-better-ceos-than-mbas>. The author also notes that under certain conditions lawyer CEOs negatively affect firm value through overly cautious firm policies. *Id.*

¹³ William E. Stevenson, *The Nature and Functions of Law*, 73 HARV. L. REV. 1018, 1020 (1960) (book review).

where decisions that violate the rule of law can cost a company millions of dollars, ruin an established reputation, and, if the violations are sufficiently severe, put executives and managers in prison.

When managers understand the legal environment of their business, they are able to make decisions that not only protect firm value but also generate new value for the organization. The discipline of law and strategy, also known as legal strategy, explores how managers in organizations can deploy their legal knowledge in a way that generates competitive advantage for the enterprise.¹⁴ Legal strategy finds value in private legal ordering, managerial decision-making, and joint collaboration between managers and legal experts.¹⁵ Skillfully deployed legal strategy can transform an organization's identity and/or reshape the nature of an industry. Whereas legal knowledge is the state of awareness of legal rules by actors in an organization and understanding how such knowledge may be deployed, legal strategy is the name of the literature that examines how legal knowledge can be a source of value.

Twenty years ago, best-selling author Larry Downes declared that “[l]aw is the last great untapped competitive advantage” for organizations.¹⁶ This fact is even more true today. The purpose of this book is to unlock how lawyers and managers can unlock the value of legal knowledge for their organizations and build a competitive advantage that rivals cannot easily match.

1.2 OVERVIEW OF THE CHAPTERS

This book contains ten chapters and explores how legal knowledge can be a source of organizational value from a variety of perspectives. The book is designed both for the scholar interested in studying this important subject and the manager or executive interested in putting legal knowledge into practice. The book uses citation methods common in the legal discipline and is guided by *The Bluebook: A Uniform System of Citation*.¹⁷ I apply this citation method not only because it is the system of my home discipline of business law but also because it offers a meticulousness of citation that enables precise identification of relevant sources of information. These sources can help the reader explore certain topics more deeply if they are of interest.

After this introduction, Chapter 2 explains how legal knowledge can be a source of value for organizations. After introducing the resource-based view of the firm, the chapter explores how legal knowledge and business strategy can intersect and shows how scholars have identified potential legal value in firms in a variety of

¹⁴ Stephen Kim Park, *Legal Strategy Disrupted: Managing Climate Change and Regulatory Transformation*, 58 AM. BUS. L.J. 711, 716 (2021).

¹⁵ *Id.* 717–18.

¹⁶ Larry Downes, *First, Empower All the Lawyers*, HARV. BUS. REV., Dec. 2004, at 19.

¹⁷ THE BLUEBOOK: A UNIFORM SYSTEM OF CITATION (Columbia L. Rev. Ass'n et al. eds., 21st ed. 2020).

contexts. The chapter also assesses whether legal knowledge can be a source of sustainable competitive advantage, a competitive positioning that has been called the “holy grail” of strategy management.¹⁸ By assessing four criteria commonly believed to be necessary to generate a sustainable competitive advantage, the chapter concludes that legal knowledge can be a source of sustainable competitive advantage, and provides a springboard for the subsequent chapters on how legal knowledge can deliver that advantage.

Chapter 3 examines how internal mechanisms of the firm can encourage the strategic use of legal knowledge and identifies key factors that foster legal knowledge within an organization. This chapter presents four attitudinal variables that influence legal knowledge acquisition: organizational citizenship, self-efficacy of organizational actors, perceived legitimacy of legal rules, and attitudes toward lawyers and the legal process. The chapter then identifies four attributive variables that can influence the maturation of legal knowledge: the presence of a lawyer-CEO leading the firm, the role of legal experts in firm decision-making, the structure of legal staffing, and the firm’s experienced intensity of regulation. Such knowledge can be cultivated by the enterprise by creating the most receptive climate possible for legal knowledge to flourish.

Chapters 4 and 5 shift focus to the organization’s interaction with its environment. These chapters identify five discrete pathways of legal strategy that firms use when interacting with markets, regulators, business partners, and other stakeholders. Each pathway represents a suite of choices that firms make when deciding how to deploy legal knowledge for the perceived benefit of the organization. Chapters 4 and 5 show how each pathway is utilized through five business criteria: perception of the law, the level of legal knowledge in the organization, the role of legal experts, the application of legal knowledge to business practice, and how each pathway reinforces organizational goals.

Chapter 4 introduces the first three pathways of legal strategy. The first pathway, termed avoidance, arises when firms lack legal knowledge, or use what legal knowledge they have, to circumvent legal obligations to others and society. Firms practicing the second pathway, known as conformance, place their primary emphasis on meeting minimum legal standards with as few resources as necessary. This pathway uses legal knowledge as a checkbox mechanism and perceives legal obligations as a list of obligations to be satisfied. The third pathway, prevention, shows how firms can address legal issues through business practices in order to avert legal liability before problems arise.

Continuing the focus on the pathways of legal strategy, Chapter 5 identifies the competitive advantage embedded in the remaining two pathways. The value pathway explores how firms can use their legal knowledge as a source of competitive

¹⁸ Norman W. Hawker, *Antitrust Insights from Strategic Management*, 47 N.Y.L. SCH. L. REV. 67, 76 (2003) (declaring that, “[t]he holy grail of strategic management is not profit maximization, but sustainable competitive advantage”).

advantage for organizations. The fifth and final pathway, transformation, highlights how organizations can leverage their legal knowledge into a resource that propels major strategic initiatives or a firm-wide shift in thinking about how the firm interacts with stakeholders.

Chapter 6 applies the pathways of legal strategy to specific challenges that an organization will encounter. The first part of this chapter applies the pathways of legal strategy to three case studies: eradication of sexual harassment, protection of intellectual property, and compliance with anti-corruption laws. This part highlights how a discrete legal issue can be addressed in different ways, and with dramatically different consequences, depending on which of the five pathways the firm chooses to implement. The second part of Chapter 6 explores how organizations can elevate their deployment of legal knowledge from one pathway to another. Specifically, this part recommends how companies can shift their legal practices from avoidance to conformance, conformance to prevention, prevention to value, and value to transformation. While not every legal requirement possesses transformative potential, firms can optimize their application of legal knowledge to the appropriate pathway to ensure that it can optimally preserve value and create value for its overall legal mix of obligations.

Chapters 7 and 8 introduce a novel and strategic approach to legal risk management. This risk management is different from traditional approaches because it incorporates a new layer of understanding risk that not only minimizes harm from legal risks but also generates a potential competitive advantage. These chapters leverage a framework known as VUCA, an acronym that identifies four dimensions of legal risk: volatility, uncertainty, complexity, and ambiguity. The VUCA concept was developed by the US military, and increasingly adopted by organizations, in order to respond to and manage progressively more chaotic geopolitical and market environments.

Chapter 7 examines the first two types of VUCA risks, volatility, which is unexpected and dynamic change, and uncertainty, which is change where the significance of a novel event remains unclear. The chapter defines volatility, identifies sources of legal volatility, and proposes that firms can strategically manage volatility risk by developing ability as an organizational trait, stockpiling resources to prepare for legal threats, and building a legal crisis management plan. This chapter then defines uncertainty, identifies sources of uncertainty, and proposes that firms can strategically manage uncertainty risk by dismantling information barriers and involving legal experts in core decision-making processes.

Chapter 8 analyzes the second two types of legal risks, complexity, which is an environment with an elaborate system of functioning that is opaque to the observer, and ambiguity, which is an environment that is so impenetrable to comprehension that it is laden with unknown unknowns that cannot be recognized. The chapter defines complexity, identifies its origins, and recommends responses to complexity risk by deconvolution of processes and restructuring of operations for clarity and efficiency. The chapter then defines ambiguity, identifies sources of ambiguity, and

encourages firms to respond to ambiguity risk by promoting public–private cooperation to develop necessary rules, practicing self-regulation and standard development, and implementing careful experimentation in the ambiguous environment and thoughtfully learning from the outcomes. Chapters 7 and 8 thus deliver a comprehensive suite of responses to legal risk that, if managed effectively, can grant firms a competitive advantage over rivals by managing such risks in a way that most firms are not, and doing so more efficiently and at lower cost.

Chapter 9 explores one of the most important legal mechanisms in modern societies and a bedrock of the market-based economy: the contract.¹⁹ This chapter shows how contracts are not just instrumental mechanisms of exchange but intrinsically valuable tools that can cultivate relationships, support interfirm efficiencies, and generate a collaborative advantage for all parties involved. The chapter defines collaborative advantage, and then shows through a three-step process how firms can generate trusting relational contracts that generate value beyond the purpose of the exchange. This chapter then examines how firms can preserve contractual relationships through carefully discouraging opportunism and defection.

Chapter 10, the final chapter of this book, cultivates an ethical approach to using legal knowledge. Legal knowledge is a powerful asset for any organization, and like any asset has the potential to be misused. After reviewing the literature discussing the ethical implications of using legal knowledge, the chapter presents three mechanisms by which ethical and socially responsible values can be a part of any legal strategy. First, this chapter identifies how the promising and underutilized United Nations Business for the Rule of Law Framework can support ethical applications of legal knowledge worldwide. Second, the chapter highlights how a closely related literature, proactive law, can accelerate the integration of ethical principles of legal strategy. Finally, this chapter shows how one of the most powerful forces in modern companies, the culture of the organization, can be leveraged to support a legal culture of integrity that integrates ethical practices and values throughout the enterprise.

Law is the information technology of the twenty-first century – a veritable “black box” of untapped competitive advantage.²⁰ Viewing law as a strategic resource can enable firms to fundamentally rethink how legal knowledge can be utilized by corporate counsel, compliance professionals, and managers alike. Embracing this transformation will unlock the capacity to generate sustainable competitive advantages that rivals are unable or unwilling to pursue. There is no better time to begin this transformation than now, and the possibilities for growth are as rich and varied as the legal environment of business that enables them.

¹⁹ David P. Weber, *Restricting the Freedom of Contract: A Fundamental Prohibition*, 16 YALE HUM. RTS. & DEV. L.J. 51, 52 (2013) (“The right to contract . . . rightly receives primary credit for the establishment of a functional, market-based economy in which predictability is prized.”).

²⁰ Downes, *supra* note 16, at 19.