VENTURE LAWYERS:
A COMPARATIVE STUDY BETWEEN THE UNITED STATES AND CHILE

A THESIS
SUBMITTED TO THE
STANFORD PROGRAM IN INTERNATIONAL LEGAL STUDIES
AT THE STANFORD LAW SCHOOL,
STANFORD UNIVERSITY
IN PARTIAL FULFILLMENT OF THE REQUIREMENTS
FOR THE DEGREE OF
MASTER OF THE SCIENCE OF LAW

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May 2002

ABSTRACT

This paper assumes that technological innovations, and most recently, information technologies, are key factors to get economic growth. Normally, entrepreneurs willing to take the risks that such a task involves, introduce these innovations into the market. In so doing, entrepreneurs need not only money, but also expert business and legal advice. In the United States, lawyers have strongly fostered entrepreneurship particularly at the beginning of the 20th century as well as at the end of that century. However, there are significant differences in the way American lawyers have achieved this goal throughout the century. The old fashion is called here the Wall Street Lawyer Model by opposition to the Silicon Valley Lawyer Model. The latter has developed a new way to practice the legal profession denominated *venture law*. According to this practice, lawyers invest in their clients. Although venture law practice has posed several legal and ethical issues –which are analyzed in this paper- its success has no precedents in the history of the United States.

Can the Silicon Valley Lawyer Model be duplicated in Chile? If so, under what conditions such a practice could be attractive in a country where there is no significant entrepreneurship? These are the questions that this work attempts to answer. A comparative study between the United States and Chile on the subject allows us to understand better what can be done to overcome the cultural, institutional and strategic barriers that affect the work of lawyers, as legal service providers, to promote new ventures. This thesis claims that lawyers can duplicate the venture law practice as long as they can create a

technological market, and shows how such a market can be produced without amending any law. The implications of this conclusion impacts a wide range of issues from the changes that have to be made to the legal education to major institutional changes in the long run.

Acknowledgments

I wish to thank my advisor, Professor Rogelio Pérez-Perdomo for his help, tolerance and patience during the research process. His comments, suggestions and kind conversation were extremely useful to organize this work. I know that this paper will not satisfy him completely, but fortunately he is wise enough to teach me that, sometimes, there is a point where everything has to stop for a while to start over later on. Doing research is a permanent dialogue, as he has taught me.

My thanks must also go to Stanford Law School. Particularly, I would like to thank Professor Tom Heller for his permanent trust, support and advice. Jonathan Greenberg, Director of the Stanford Program in International Legal Studies, was a good friend who was always willing to facilitate my work. Dean Kathleen M. Sullivan helped me a lot by granting me the Lieberman Fellowship to finance my research during the academic year. Professor Marta Vides and Professor Erik Jensen were good friends and I learned beyond I deserve from them.

I must thank Carola Vásquez for hours of conversation about some ideas of my thesis, for joining me in a couple of projects that I had in mind, and particularly for her friendship. Professor José A. Caballero has been an example of professionalism and I have benefited very much of him.

Craig Johnson from Venture Law Group was extremely kind in allowing me to interview him in the middle of a busy agenda. Cristian Shea and David Smolen, founders of Latinvalley, Inc, deserve a special mention, as they were always willing to collaborate with my work and because they encouraged me to take the path of fostering entrepreneurship.

My studies were also financially supported by the Fundación Fernando Fueyo that granted me the Fueyo Fellowship, and by Diego Portales Law School, where I have been a law professor for nine years. I gratefully acknowledge the personal support of Professor Leonor Etcheberry and Professor Mauricio Duce.

Thanks to all the 2002 Spils Fellows for sharing ideas and emotions with me in a hard year. The Staff of the Robert Crown Law Library was efficient and kind. It was a pleasure working in the library with them. Also I must acknowledge the wonderful work achieved by Rachel Wilkins, who helped me translate part of this work from Spanish into English as well as the work of Jessica Steinberg, who improved a lot my English by editing the thesis.

Last, but no least, there is my family -my children Santiago, Domingo and Isabel and my wife, Francisca. Their generosity and love go beyond what is allowed to ask. They gave me one year of their lives to learn a little bit more about the world. Gratitude is too weak a word to describe what I owe them.

VENTURE LAWYERS:
A Comparative Study between the United States and Chile

Contents

INTRODUCTION

According to certain theories on economic growth, entrepreneurship is a necessary, yet not unique, element in generating wealth (Thurow, 2000; Timmons, 1999). If one considers these theories sufficiently persuasive, then public policies in developing countries should promote the development of entrepreneurship.

There is often a misunderstanding of the words "entrepreneurship" or "entrepreneur" when they are used in everyday language. These words are ambiguous, as they connote several possible meanings.[1] Consequently, in order to speak of "entrepreneurship" as an economically desirable end, it is helpful to clarify from the beginning the meaning such a word will have in this investigation.

The word "entrepreneur" is used herein to refer to a person who, through creativity, is capable of offering the market (a) a lower-cost product or service that has the same quality as available products; or (b) an equal-cost product or service that is of better quality than existing products; or (c) a new product. The activities required to achieve those

[1] As Howard H. Stevenson points out: "There are several schools of thought regarding entrepreneurship, which may roughly be divided into those that define the term as an economic function and those that identify entrepreneurship with individuals traits. The functional approach focuses upon the role of entrepreneurship within the economy. In the 18th century, for instance, Richard Cantillon argued that entrepreneurship entailed bearing the risk of buying at certain prices and selling at uncertain prices. Jean Baptiste Say broadened the definition to include the concept of bringing together the factors of production. Schumpeter's work in 1911 added the concept of innovation to the definition of entrepreneurship. He allowed for many kinds of innovation including process innovation, market innovation, product innovation, factor innovation, and even organizational innovation. His seminal work emphasized the role of the entrepreneur in creating and responding to economic discontinuities. While some analysts have focused on the economic function of entrepreneurship, still others have turned their attention to research on the personal characteristics of entrepreneurs…These studies have noted some common characteristics among entrepreneurs with respect to need to achievement, perceived locus of control, and risk-taking propensity." (Stevenson, 1999: 8-9). On the subject see Sahlman, Stevenson, Roberts and Bhide (1999) part one, titled "Entrepreneurship –What is it?"

objectives defines "entrepreneurship" in this paper. Briefly, entrepreneurship is innovation. The entrepreneur also assumes the underlying risks in introducing the innovation to the market.

The owner of a business is not, for example, an entrepreneur in the aforesaid sense, no matter how much risk he absorbs. If a person leaves his stable and secure job to set up his own business he or she does not automatically become an entrepreneur unless the business is innovative. Risk is only one component of entrepreneurship, and is not sufficient on its own.

An employee who creates a new product within a previously established company is not an entrepreneur either. Normally, this case is called *intrapreneurship*.

In other words, entrepreneurship is understood hereinafter as the sum total of creativity, innovation, autonomy and risk. Absent any one of those characteristics, the word does not apply.

This paper will only look at entrepreneurship in connection with technological innovation and, particularly, information technologies. This fact narrows the use of the word in the text even further.[2]

[2] This does not mean that innovations in other areas are unimportant. The restriction is imposed to avoid highly complex analyses of financing that do not relate to those at central issue in this paper. In fact, as shall be seen hereinafter, in the description of the interaction between entrepreneurs, attorneys and investors, emphasis is placed on the so-called "non-traditional forms of financing" only. Innovations that make use of traditional forms of financing, such as banks or project finance, among others, cannot be covered in this investigation for reasons of time and space, although lawyers do play a relevant role in such financing as well.

The central issue that this paper seeks to enlighten is the following: Do Chilean corporate attorneys foster entrepreneurship? And, the next logical question after the above is: Should Chilean attorneys foster entrepreneurship? The first question is descriptive while the second is prescriptive. They are not simple questions for the following reasons: First of all, Chile is not a developed country. As a result, its economic growth has been tied historically to the exploitation and export of raw materials, and not the creation of technological innovations. Second, Chilean lawyers have been educated to take on only the role of intermediary between the business world and the legal system. Third, the legal institutions that are needed to foster entrepreneurship are not sufficiently developed. The capital market, rules of corporate governance, non-traditional forms of financing, tax incentives and labor regulations do not create an environment favorable to entrepreneurship. And fourth, the risk-taking propensity that has helped entrepreneurs to triumph in other countries is not commonly found among the risk-averse initiatives of Chilean entrepreneurs.

Lawyers and entrepreneurship have a close relationship in other countries. The paradigmatic example is undoubtedly the interaction between lawyers and entrepreneurs in the United States. Although that interaction has been irregular throughout the history of the United States, attorneys certainly deserve some of the credit for the emergence and development of significant business initiatives.

In the last 12 years, perhaps like never before, American attorneys have played a particularly active role in promoting entrepreneurship. The advent of computers, the creation of information technologies and the commercial exploitation of the Internet have established a propitious environment to achieve that goal. Technology has led to innovations at a speed that is continuously amazing. Some lawyers have conceived new practices to benefit from this phenomenon and help give it shape. These new practices have, in and of themselves, created innovation in the provision of legal services. One of those practices, known as *venture law*—where lawyers invest in the companies they also advise--has been developed in particular in Silicon Valley in California, located south of San Francisco and north of San Jose. The practice of venture law in Silicon Valley has made attorneys both entrepreneurs and investors.

Is it possible to duplicate a practice like this in Chile? In other words, can Chilean lawyers foster entrepreneurship? The hypothesis that I will defend here is that it is possible to implement the practice in Chile, but only under certain conditions. Those conditions include: culture, institutions and strategy. Culturally, lawyers must perceive themselves not only as intermediaries between their clients and the legal system, but also as business counselors. Consequently, changes must be made to the legal education in order to aid this evolving perception. Institutionally, the country must create a basic framework to facilitate the creation of a technologically innovative market. Finally, strategically, attorneys themselves must design new strategies to guide the way in which they interact with their entrepreneur clients.

When the paper discusses the possibility of duplicating the practice of venture law in Chile, it concentrates essentially on strategic conditions and analyzes only tangentially, to the extent relevant to the analysis, some of the so-called cultural and institutional conditions. For the same reason, another way of asking the question that I wish to answer is: if there is no technological entrepreneurship in Chile, under what strategic conditions can Chilean law firms create a market that is sufficiently attractive so as to raise capital? And if this is possible, why would it be desirable and convenient for attorneys to assume that role?

Duplicating in Chile a legal practice like venture law supposes to understand in depth such a practice. Therefore, the first part of this paper concentrates on describing the interaction between attorneys and entrepreneurs in the United States. This part aims to show how attorneys fulfilled a significant task at the end of the 19th century and the early 20th century in promoting and developing entrepreneurship, and how that role, however, was ultimately postponed and, in certain cases, abandoned as law firms grew gradually in size. Large law firms, which are grouped together here under the expression *the Wall Street Lawyer Model*, engaged in advising large companies that they had helped grow, rather than continuing focusing in new ventures. This part also shows how American corporate attorneys began, for different reasons, to have a bad reputation in popular culture although the services rendered, in most cases, added value to the transactions in which they intervened. Finally, the first part discusses the evolution of Silicon Valley law firms that launched a new business model in order to correct the deficiencies of the Wall Street Lawyer Model and create forms of active promotion of entrepreneurship. Here this will be

called *the Silicon Valley Lawyer Model*. The reader should, at the end of the first part, be clear as to the differences between the Wall Street Lawyer Model and the Silicon Valley Lawyer Model and appreciate, at least with respect to the promotion of entrepreneurship, how the practice of law changed in the United States.

The second part of this work concentrates on Chile and on the question of whether the Silicon Valley Lawyer Model can be duplicated in that country as a way of fostering entrepreneurship. The hypothesis, as I indicated earlier, is that it is possible in the medium term provided certain conditions are met, but an empirical test will be required

Summarizing, the methodology used in this paper is a mixed approach to the subject of analysis. On one hand, a review of U.S. literature on the relationship of lawyers to entrepreneurship provides an outline of that relationship throughout the 20th century. Through that literature one can also analyze the most recent and successful forms of this interaction. That description is then compared to the way in which Chilean attorneys have been involved in the promotion of new initiatives, with an emphasis on the differences instead of the similarities. On the other hand, several plausible empirical hypotheses are put forth that aspire to show that Chilean attorneys can fulfill an important role in the promotion of entrepreneurship. These hypotheses are what are presented to the reader.

Also, I must point out that there is no literature on Chilean lawyers directly related with this subject. Therefore, a significant part of my analysis on lawyers and

entrepreneurship in Chile is based on my own experience as a corporate lawyer[3] as well as a law professor[4], interviews, press articles, and personal participation in the events and projects mentioned in the text.[5]

[3] During March 1997 and April 2000, I was a senior associate in Carey & Cia., the Chile's largest law firm.
[4] Since 1996 I have been a law professor of business law in Diego Portales Law School in Chile.
[5] I have interviewed a representative sample of Chilean corporate lawyers. Also, I had an interview with Craig Johnson, founder of Venture Law Group. His firm is the case study of the first part of this text. Finally, I have been actively participating in the design of the LatinLawVentures project analyzed as case study in the second part of this work. Cristian Shea and David Smolen, founders of Latinvalley, were interviewed too.

Part One
VENTURE LAW IN THE UNITED STATES:
Changing the Way Lawyers Practice the Legal Profession

I. Lawyers and Entrepreneurship in the United States

There is a certain consensus that U.S. corporate attorneys have played an important role in the growth of their country's economy. This assertion is primarily based on the role that they have played in the promotion of entrepreneurship. For example, at the end of the 19th century, when Wall Street was still far from being what it is now, the first lawyers who set up shop in the Big Apple did just that: fostering new ventures. The prestige of those lawyers was built partially on the basis of legal and business counsel they provided to companies who were then in an early stage of development. Those companies created new technologies and services, and expanded on existing ones. Their lawyers were there to help them. This is what happened, for example, with the railroad industry, the banking industry and the oil industry. Law firms – still small in comparison to what they are today – fulfilled a significant role as advisors to pioneer companies in the industrial era (Smigel, 1964).

Craig Johnson has highlighted this fact clearly when he recounts the evolution of Shearman & Sterling, one of the most prestigious and influential law firms in the United States, founded in 1873:

> "Shearman & Sterling became the legal and business advisor to Gould, who, with the firms' help, seized control of the Union Pacific Railroad in 1875. Gould was involved in a variety of other business enterprises, including Western Union and the telegraph. Sterling also played a key role in advising many other early stage enterprises, including a small New York bank that would eventually become Citibank, an important Shearman & Sterling client even today...[John W.] Sterling had the great good fortune to practice law in New York City –then the center of the financial universe- at a time when America was starting to flex its industrial muscle. The railroad and telegraph industries, the oil and gas industries, the automobile industry, the chemical and steel industries, the banking conglomerates that financed them – Sterling was there at the beginning, and he and his colleagues played an important role in developing many of these industries" (Johnson, 2000: 325-326).

Throughout the first half of the 20th century, law firms were also the most appropriate place to seek legal and business counsel. According to Johnson, one possible explanation for this phenomenon is that: "A good corporate lawyer comes into contact with a variety of businesses and business problems, and has the breadth of experience and perspective that even the most successful entrepreneurs often lack. It was natural for corporate lawyers to evolve into business partners with their clients and even become entrepreneurs themselves–which was much easier in Sterling's day, when the businesses that would dominate American business by the middle of the twentieth century were still in their embryonic stages" (Johnson, 2000: 326) Law firms became entrepreneurs in and of themselves by introducing organizational innovations, and during those years, they experienced a slow gradual growth. Law firms in New York, Boston, Washington, D.C., Texas and later, San Francisco, grew in size alongside their clients. Law firms grew to the extent their clients prospered and became a more dominant force in the market.

Consequently, in the early thirties of the 20th century, the lawyer-client relationship was fundamentally based on mutual trust more than on a contractual lawyer-client relationship since both types of businesses (legal counsel and the client's business) were in

a process of creating more expansive and sophisticated business practices. Both aspired to create a market that would yield significant profits in the medium term. These were the first steps made to transform a small law firm into a large law firm, and a small client into a large domestic company. Thus, in the beginning, the lawyer was a sort of an "interested friend" of the owner or manager of the company-client and together they planned, at social or business gatherings, the strategies to position the company favorably and make it grow.

In this regard, law firms in the early 20th century were situated in a similar position to the one now occupied by Silicon Valley attorneys, due to the advent of information technology. In both periods, law firms were directly involved in their clients' new initiatives and heavily aligned themselves with their clients' interests. In addition, law firms held similar relationships with financial institutions in both periods. At the beginning of the 20th century, law firms developed close ties to banks willing to finance the projects of their entrepreneurial clients. At the end of the same century, Silicon Valley lawyers forged direct access to investors and venture capital funds. As Friedman asserts:

> "When giant enterprise formed in the late nineteenth and early twentieth centuries, lawyers made key links between management of railroad and manufacturing corporations, on the one hand, and, on the other, the investment banking houses of Wall Street and Europe, which underwrote the vast consolidations of 1898-1906. Lawyers designed the risk-reward-and-security structures to attract different types of investment and often acted as salesman of new issues of securities." (Friedman, 1989: 557-558)

However, although both eras have aspects in common, they are also different. The main difference is the speed at which entrepreneurship develops in current-day practices and the transformations it effects in the organization of law firms. In the first era – the Wall Street Lawyer Model – small law firms gradually became large law firms, and

providers of all types of legal services. In the second period -- the Silicon Valley Lawyer Model – the law firms focused on certain very specialized services and the tendency was to decrease in size.

II. The Wall Street Lawyer Model

The phenomenon of the exponential growth of law firms in the United States and the positioning of attorneys as a socially privileged profession has been studied at length by US scholars (Abel, 1995; Kronman, 1993; Nelson, Trubeck, and Solomon, 1992; Galanter and Palay, 1991). For example, Richard L. Abel points out that lawyers were able to monopolize legal assistance rapidly by setting up barriers to entry in professional practice, primarily through American Bar Association policies ("ABA"). As attorneys became influential people, and were perceived as such, both privately and publicly, lawyers exerted control over the legal counsel market as a tool to restrict access by new members to the elevated social status. The practice of law thus became a sort of aristocracy, based not on lineage, but rather on membership in a highly regarded profession (Abel, 1995).

Nonetheless, establishing barriers to entry is not sufficient to monopolize a market (Osiel, 1990). The laws of economics also dictate that one must convince potential consumers that the services offered by a company add value and that it is highly unlikely that those services can be rendered efficiently by other providers (Gilson, 1984). This is particularly problematic for lawyers to do, as Friedman expresses: "To understand the way lawyers work and have worked in the United States, it is important to realize that there have never been clear boundary lines marking off the work of lawyer, from the work of

occupational groups in society. That is, aside from courtroom work, there is almost nothing that lawyers do that is unequivocally and exclusively theirs" (Friedman, 1982: 1.14) However, Abel holds that lawyers have several advantages to complicate the legal task beyond lay competence. Essentially, Abel points out that as lawyers normally are legislators, judges or members of the administration, so they can use the state power to create a sort of monopoly for legal services, particularly by granting an exclusive jurisdiction to legal institutions. Also, lawyers can regulate the entry to the legal market by forbidding lay competition and by establishing special qualifications and skills to practice the profession (Abel, 1995).

But, beyond the monopoly in legal services administrated by lawyers, how can we explain the growth of law firms in the United States? One of the most influential studies on the matter, which has been simultaneously praised and criticized (Johnson, 1991), is the book by Marc Galanter and Thomas Palay, *Tournament of Lawyers: The Transformation of the Big Law Firm*, published in 1991. According to these authors, large law firms have proven to be a great success. They establish the standards that must be followed in providing legal counsel, they possess a high degree of specialization, they are organized internally in teams, and they represent their clients in all types of forums. Large law firms, they hold, have become a paradigm of professionalism. Furthermore, large law firms earn the highest income and may advise a larger number of clients. Therefore, the transition from a single or group of attorneys providing legal services ("law office") to a large law firm is due in part simply to microeconomic rules. The law firm now embodies the efficient practice of law. Kronman reasserts this idea by highlighting that although only

approximately one-fourth of all private practicing attorneys in 1980 worked in a large law firm, these firms continued and still continue to be leaders of the bar (Kronman, 1993: 273).

Nonetheless, Galanter and Palay assert that the fundamental reason law firms have grown is the aspiration of young attorneys to be partners (Galanter and Palay, 1992: 32). Their theory is as follows: "We suggest that the big law firm, as presently structured, has a built-in 'growth engine' and that roughly half of its recent growth is a by–product of the 'promotion to partner tournament' used by law firms to protect the partners' human capital and to motivate the associates. This tournament is essential to the firm's structure and in order to maintain it the firm must grow exponentially. If a firm's required growth outpaces either its revenue base or the relevant supply of labor, further growth becomes impossible without internal change. A firm that does not or cannot grow will be forced to transform itself or it will fail." (Galanter and Palay, 1992: 33).

Large U.S. law firms are typically organized in a similar way. It is that form of organization and the type of work they do that make them the core of what this paper calls the Wall Street Lawyer Model, which will now be explained in greater detail.

First of all, according to this model, partners in large law firms have no personal clients. In other words, the clients "belong" to the firm and not to one attorney in particular. For the same reason, the earnings of partners are shared proportionally according to a formula upon which they agree.

Second, lawyers who are not partners in the firm are called *associates*. The firm expects associates to dedicate all their time to the matters of the firm's clients.[6] The associates have varying responsibilities within the firm according to their age, experience, prestige and connections.[7]

Third, large firms normally represent large companies, both national and transnational, that require all kinds of specialized services. These services are usually rendered by a team of attorneys within the firm. The relationship between the firm and its clients also tends to be long-lasting.

Fourth, the work inside large law firms is highly specialized (Kronman, 1993: 275-276). The firm will quite frequently cover all areas of the practice of law. However, large law firms prefer to advise companies instead of individuals[8] so areas linked to family law or even litigation are subcontracted out to other specialized firms. Large law firms concentrate in particular on corporate matters and business structuring.

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[6] Kronman highlights the lengthening of the working day of the lawyers practicing in such firms. He asserts: "The data here are thin, but they all point toward the same conclusion: that lawyers in large firms are on average working longer hours than they used to. Thus, for example, in 1987 the *National Law Journal* reported the results of a nationwide study indicating that in the seven hundred large law firms surveyed (firms with seventy-five or more lawyers each), average hours billed per lawyer rose by 8 percent between 1976 and 1986, to 1685 hours per year. As one would expect, the number of hours that lawyers in large firms bill varies considerably from one region to another, but the tendency everywhere is upward, most dramatically in large cities such as New York, Chicago, Los Angeles, and Washington." (Kronman, 1993: 281). My guess is that today attorneys should be billing, at least, 2000 per year.

[7] As Kronman points out: "The effort to recruit qualified law students has also identified. More firms now visit more schools; summer programs have become more elaborate and are carefully rated in the legal press; and the use of brochures and other advertising techniques that would have been considered unprofessional a generation ago are now viewed as a legitimate recruiting device." (Kronman, 1993: 280).

[8] Kronman points out: "Thirty years ago most corporate law firms had a relatively stable set of clients and represented them in matters both ordinary and exceptional. Today their clientele tends to be more fluid and relations with individual clients less continuous--restricted, for the most part, to extraordinary events that demand a form of specialized legal knowledge that even very large companies often find it uneconomical to develop on their own. Except for their vastly greater size, nothing distinguishes today's corporate law firms from their predecessors more dramatically than this shift in the client-firm relationship." (Kronman, 1993: 277).

Fifth, large law firms need technology support systems to handle the volumes of legal work performed daily in an efficient manner. In recent years, thanks to technology, law firms have introduced and implemented sophisticated knowledge management systems. E-mail, videoconference and other sophisticated forms of communication with the client are also increasingly necessary and frequent. Computers have also become an essential component of legal research[9] and important to the administration of databases inside the firm.

Finally, the sixth point is that attorneys in large law firms must be exposed from time to time to new knowledge. The need for continuing legal education is a key factor to staying on top of the evolution of the law, which is ever more sophisticated. For that same reason, the old treatises or manuals have become progressively obsolete and accordingly, are fast being replaced by new publications.

Galanter and Palay have added, as said above, one last characteristic to this form of corporate organization of large law firms, which to them is the key to the growth in size of those firms: the competition among associates to become a partner in the firm.[10]

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[9] For example, let's think of the interaction of law firms with companies such as WestLaw or Lexis-Nexis.

[10] Galanter and Palay claim: "The core of the big firm, we submit, is the 'promotion to partnership.' This is our shorthand for the organization of the firm around the expectation that the junior lawyer can cross the line by promotion and become a partner. Partners and juniors are not equals, but form a hierarchy with command and supervision exercised by partners. But the junior lawyers are neither transient apprentices nor permanent employees. They are peers, fellow professionals of presently immature powers, who have the potential to achieve full and equal stature. Firms can offer this promise only when they are confident that they will attract sufficient work to keep these young lawyers busy. That is, the senior lawyers must have either clients who produce more work than the senior lawyers can handle themselves or a reputation that will attract such clients." (Galanter and Palay, 1992: 35-36)

The growth of law firms, as characterized above, has created a high degree of dependence between the firm and its clients. According to Galanter and Palay: "From its origins the big firm was haunted by a sense that the profession had compromised its identity and had itself become a branch of business. By the 1930s, the scale and stability of these firms was recognized in the pejorative term 'law factory'. The phrase captures not only the instrumentalism, but the systematization, division of labor, and coordination of effort introduced by the large firm." (Galanter and Palay, 1992: 36-37).

After describing the way in which the Wall Street Lawyer Model is organized, it is pertinent to ask now: what do large law firms really do? And do they or do they not foster entrepreneurship? The simple answer to the first question is obvious: Large U.S. law firms provide legal counsel to their clients in order to protect the latter's interests. But this response is the same as saying what attorneys in general, not just large law firms, are supposed to be doing. In the section that follows, I will briefly summarize existing literature on the role of large law firms, and I will discuss whether they effectively encourage entrepreneurship.

Above all, it seems clear that one of the things that attorneys do is inform their clients as to what is permitted and forbidden by law. This allows both the lawyer as well as the client to work together on planning the future behavior of the client according to specific guidelines. It is predictive work (Abel and Lewis, 1989).

Corporate attorneys also contact influential people who can help better protect the interests of their clients (Abel and Lewis, 1989). The dividing line between what is ethically correct and what is not is often very obscure. The exchange of favors is certainly a delicate matter and, on occasion, verges on corruption.

Corporate attorneys represent and speak on behalf of their clients in different forums: courts, legislatures and the administration (Abel and Lewis, 1989). However, they also do so in private forums by negotiating deals for their clients. In this latter relation– negotiations--, attorneys build legal structures that aspire to efficiency in order for their clients to do business at low transactions costs. For the same reason, the practice of law often used to be influenced by the expectations that clients invest in it. In this way, there is a reciprocal interaction between the client and lawyer that gives shape to the practice of law.

Those are the most typical functions performed by attorneys in large law firms. Of course, lawyers also usually make important connections between their different clients in order to help them prosper in their respective businesses. The lawyers do not render legal counsel only but also business assistance. That assistance, however, is very general and basically centered on the transaction in question, case by case. It is common for the clients themselves to handle important business decisions alone since they are the ones who know the details of the market in which they compete and the strengths and weaknesses of their corporation. Still, it is not infrequent for attorneys to participate actively on the boards of directors of their clients.

Although strongly linked to entrepreneurship in the beginning, the Wall Street Lawyer Model has gradually deviated from ventures. Nowadays, the larger a law firm is, the larger in size its target client. Law firms grew with their clients and stayed in that stratum in order to focus solely on large companies capable of paying significant fees. For at least 60 years (from 1930 to 1990), entrepreneurship was not a priority in large American law firms.

During that period of time, the Wall Street Lawyer Model was also losing the good reputation it had enjoyed in its early years (Bennet, 2001; Kronman, 1993). An interesting debate has arisen recently on whether corporate attorneys merit praise or deserve only moral reproach. Apparently, the evaluation has not been in any way positive.

Over the years, the legal profession has become one of the most desirable careers in the United States. Simultaneously, however, lawyers have earned, unfairly or fairly, an extremely bad reputation (Nader and Smith, 1996). In fact, according to several surveys, more than 90 percent of surveyed parents do not want their children to become lawyers (Rhode, 2000). This statistic provides a strange contrast to the growing number of young people who are struggling for admission to law schools. Yet, there is no mystery behind this. Both lawyers and these young people pursue a career in law only because it is one of the most profitable careers, and money really matters to a significant part of American society. Nevertheless, it is pretty obvious that the objective of earning as much money as possible--no matter what kind of interest is at stake--is not a problem exclusive to the legal

profession. It is common to all kinds of businesses. Therefore, that idea does not fully explain why lawyers, particularly corporate lawyers, have such a bad reputation. Researchers have found several other elements that might justify this perception.

One of the most frequent client complaints is that corporate lawyers simply represent a transaction cost. According to this point of view, corporate lawyers do not add value to the transaction but are merely a necessary evil. They provide the technical language expertise that it is required in order to write a contract. Many clients believe that this is all that a lawyer does. Indeed, there seems to be a consensus that lawyers often handle issues that could be easily solved more cheaply by non-lawyers (Rhode, 2000; Friedman, 1982). As Gilson and Black describe this criticism: "Lawyers as a group are often criticized as non-productive actors in the economy. Engineers, it is said, make the pie grow larger. Lawyers only rearrange the slices, shrink the pie, and take some for themselves in the process." (Gilson and Black, 1995: 5) These authors also point out that clients deem legal fees to be "a tax on business transactions." Although Gilson and Black disagree with this point of view, according to conventional wisdom, legal fees are often viewed as an unpleasant expenditure for clients as they see legal work as an artificial intermediation (Rhode, 2000).

Another common criticism is that corporate lawyers always raise legal issues that delay closing the deal. Clients feel that, instead of acting as facilitators, corporate lawyers seek to delay the end of the transaction as long as possible in order to bill more chargeable

hours. An excellent description of this point written by a journalist, cited by Gilson and Black, is the following:

> "What happens between lawyer and client today goes something like this: The lawyer sits at the elbow of the businessman while contracts are being negotiated, that is, while the deal is being made. Then, once the principals feel an agreement has been concluded, the lawyers assure them it has not. After further negotiation, the lawyers 'draft a contract' – reduce the deal to written law – and pass it back and forth accompanied in each passage by increasingly minute argumentation (e.g. 'We believe in all fairness that the law of Luxembourg should govern in the event of non-performance under Para.V(e)(ii)' etc.,etc). Once they have decided that neither party can be further hoodwinked or bullied, the typist prepares many copies to make 'doubly sure' (making doubly sure in this special fashion is 28 per cent of law practice), and the clients sign all of them. Then they smile at each other and shake hands, while glancing sidelong at their lawyers, who are still scowling (it's part of the fee-action). This little drama, in numerous manifestations, is the beginning of law – perhaps, even, the final heart of it as well." (Gilson and Black, 1995: 6).

Of course, lawyers argue that they behave this way because it is their professional duty to protect their clients' interests. Nonetheless, clients often do not see evidence of this protection and, therefore, do not value these efforts.

A third common complaint is that people believe that lawyers have lost their connection to the ideals of justice. What this means is that the average person believes that lawyers are more concerned with earning as much money as they can rather than evaluating what is fair and what is unfair. If there is a potential client willing to pay their fees, many lawyers do not think twice about representing that client, regardless of morality. Lawyers may be willing to be amoral in order to defend a client's interests without regard to the ethical merits of a case. This criticism is not exclusively applicable to litigators, as it might seem at first sight, but also to corporate lawyers doing business with large companies. Honest clients do not overlook these morals, but take notice of lawyers' greed and the amount of money earned at their expense. In Gilson and Black's words: "In an extreme

version, business lawyers are perceived as evil sorcerers who use their special skills and professional magic to relieve clients of their possessions." (Gilson and Black, 1995: 5) In fact, a classic advocate definition in the U.S. states that a lawyer is "a learned gentleman who rescues your estate from your enemies and keeps it for himself."

Perhaps, most caricatures, novels and movies that criticize lawyers' behavior are based on the above characteristics. The idea that lawyers are "sharks" is commonplace today (Asimov, 2001, 2000).

To summarize what has been said at this point, clients and general public perceive traditional corporate lawyers as ineffective in business transactions; a deal-killer; and, ethically speaking, greedy and amoral. In other words, they do not contribute added value, they are normally seeking to paralyze negotiations by raising unnecessary legal issues, they charge expensive fees, and they are willing to defend any interest for money. Nevertheless, to be fair, we should ask: is this picture of the legal profession totally accurate? This question addresses the issue of whether or not corporate lawyers add value to the transactions in which they participate.

In a 1984 article, Ronald Gilson asked the question of whether business lawyers add value to the transactions in which they are involved. Do lawyers add value, or do they simply guide and inform their clients regarding the complex regulations applicable to the case? Do lawyers add value, or do they simply help their clients earn more money by negotiating the deal well? What do attorneys really do? And regardless of the answer to that question, is there value in what lawyers do? These are some of the questions that

Gilson tries to answer in his article. His theory, known as B*usiness Lawyers as Transaction Cost Engineers*, is an attempt to prove that lawyers do actually add value when they advise their clients, provided certain conditions are met (Gilson, 1984).[11]

Of course, there have been other efforts apart from Gilson's to show that lawyers certainly do add value under certain circumstances despite the poor reputation that they have earned (Barondes, 2000; Thompson, 1995). This is important to bear in mind, as the legal profession, when practiced well, is one that can contribute significantly to social well-being. One way of doing this, as we shall see below, is by promoting entrepreneurship.

[11] I cannot explain here the Gilson's theory, as it goes beyond the scope of this investigation. Nevertheless, I will briefly summarize its main foundations. The starting point in Gilson's theory is another theory that comes from the world of finance: *The Capital Asset Pricing Model*. According to Gilson, it is a fact that there are often wide gaps between clients and their lawyers as to whether the work of lawyers truly has any value. Nonetheless, there is at least one thing clients share with their lawyers: agreement on the standard by which to resolve performance issues. Gilson asserts: "... both sides do seem to agree on the appropriate standard by which the performance of business lawyers should be judged: If what a business lawyer does has value, a transaction must be worth more, net of legal fees, as a result of the lawyer's participation." (Gilson, 1984: 243). However, according to this author, one error is also shared: "...the common failure of all of these views is not their differing conclusions. Rather, it is the absence of an explanation of the relation between the business lawyers' participation in a transaction and the value of the transaction to the clients. In other words, precisely how do the activities of business lawyers affect transaction value?" (Gilson, 1984: 243). It is exactly that gap that Gilson's theory attempts to close. According to *the Capital Asset Pricing Model*, market forces are best suited to appraise capital assets. If this theory were correct, there is nothing business lawyers could do to augment the value of the transaction. By definition, they simply do not have the power to do so. Lawyers would thus become a transaction cost. However, the *Capital Asset Pricing Model* is constructed on the basis of several assumptions that simplify the analysis. The model is, therefore, an ideal world that is usually different from the real world. If this were so, Gilson therefore proposes that attorneys add value to the extent they structure a real transaction in a way that approaches the ideal world predicted in the theoretical model. The closer they are, the more added value there is. Gilson illustrates his proposal with a typical case – an acquisition agreement. He explains in detail that the lawyer's intervention truly augments the aggregate value of the transaction (despite the legal fees involved) if he aims to bring the end result of the transaction closer to the assumptions of the *Capital Asset Pricing Model*. In summary, the theory of *Business Lawyers As Transaction Cost Engineers* depicts the relationship between legal skills and transaction value. For the same reason, as Gilson himself develops, his proposal has material consequences for legal education. Thompson has summarized Gilson's proposal very well: "The core of the theory [the Capital Assets Pricing Model], that in an efficient market assets will be valued according to their expected return and systematic risk, leaves little room for business lawyers to create value. Yet the theory makes certain assumptions that do not show up in real world transactions: that investors have common time horizons, that parties have the same expectations about risk and return of the asset, that there is no transaction costs, and that information is costlessly available. Divergence of a deal from these perfect characteristics can prevent parties from reaching agreement. Gilson focuses on how lawyers as transaction cost engineers can structure real world deals to make them fit the assumptions of the model more closely, thereby permitting the parties to reach an agreement that they otherwise would forego". (Thompson, 1995: 315-316).

III. Venture Law and the Silicon Valley Lawyer Model

A) An Overview

The most salient characteristics of what has been called The Wall Street Lawyer Model are described above. I will now contrast that model to the Silicon Valley Lawyer Model in order to illuminate how the latter model has fostered entrepreneurship in a totally innovative manner and changed the practice of law in this field.

It is impossible to understand thoroughly the reason why T*he Silicon Valley Lawyer Model* has been so successful without first understanding some key cultural elements that arose in the Silicon Valley region at the end of the 20th century. Several studies on the surprising venture success of Silicon Valley assigned a prominent role to the notion of a "community of interests" (Kenney, 2000), an idea that prospered despite the high level of competition that tends to result from technological entrepreneurship. The players involved, whether entrepreneurs, lawyers, investors or the academic world, uniquely and spontaneously established a genuine relationship of cooperation. This is surprising because there is frequently a relationship of mutual distrust among those four players (Reed, 2001). As a result, it is common to find several formal rules that regulate potential conflicts of interest between them (McAlpine, 1999).

The community that emerged in Silicon Valley diluted conflicts and aligned interests by making the relative success of each player dependent upon the relative success

of the others. As we will see, a set of unplanned economic incentives[12] contributed to the development of some social practices founded on mutual trust. That trust triggered the formation of a sound business community tied to innovation as well as capital. This community in turn created a virtuous circle of business relations where synergies converged gradually, but speedily, and leveraged the economic growth of the region. Those practices will be analyzed here.

The cultural aspects of Silicon Valley, in particular the sense of community and level of cooperation, form part of the essential ingredients that led to an abrupt jump in wealth in the United States in the last decade of the twentieth century. Also adding to the development of wealth was the efficiency of the existing legal structure that bolstered the efforts of Silicon Valley lawyers.

Diverse elements comprise the existing legal structure. First of all, there was a capital market with extraordinary levels of access, transparency and liquidity.[13] Second, there were clear rules of corporate governance, with particular emphasis on the protection of minority shareholder rights (Monks and Minow, 1995). Third, creativity was promoted through stock option plans. Those plans, offered to executives of growing companies, helped merge the interests of all employees in a company, since the success of the company could bring each of them significant individual earnings. Fourth, there were clear rules on the protection of intellectual property (Suchman, 2000). Fifth, there were flexible tax and

[12] Those incentives emerged gradually with the exponential development of technological innovation in Silicon Valley.

[13] The creation of a special market for technology company transactions such as NASDAQ, was certainly a key step in this process.

labor regulations. And sixth, non-traditional methods of financing were encouraged, such as venture capital funds (Southwick, 2001). .

In summary, a work community with mutual interests embedded in an extraordinarily efficient institutional infrastructure reinforced technological innovation as one of the principal sources of generating wealth. In that community, as we shall see, the Silicon Valley Lawyer Model played an important role, using this structure as its starting point.

Much research has been done on many of these factors (Lee, Miller, Hancock, and Rowen, 2000), but the role of corporate lawyers in entrepreneurship has not received the attention it deserves as a crucial link in the creation of the Silicon Valley miracle. This is especially true because entrepreneurs starting new ventures face a complicated set of legal hurdles, and lawyers are ultimately responsible for identifying and suggesting solutions to these legal puzzles (Bagley and Dauchy, 1998).

Lawrence Friedman published what seems to be the first paper on the subject in 1989, when the Silicon Valley Lawyer Model was in its incubation stage. With foresight, Friedman depicts the situation of Silicon Valley lawyers in a case study:

> "As a subject of study, the Silicon Valley is nearly ideal. It has a dense concentration of lawyers, and a dense concentration of new industry. The lawyers claim that their role in the Valley's boom has been extremely influential. The industry and the legal practice that has grown up around it are both young; their entire histories are within the grasp of living memories." (Friedman, 1989: 556).

Friedman's work also contains very interesting data on the history of Silicon Valley lawyers.[14]

One of the phenomena characteristic of small and mid-sized law firms in Silicon Valley was their capacity to attract clients from the high technology industry developed in the Valley at the end of the eighties and throughout the nineties. This is particularly notable when one takes into account the physical proximity of the large San Francisco law firms. Several hypotheses may explain this fact.

First of all, high technology companies developed simultaneously to the Silicon Valley law firms so a neighborly kind of trust evolved. Suchman asserts in this regard:

> "In contrast to their San Francisco counterparts –and in keeping with small-town attorneys elsewhere- Silicon Valley lawyers embrace a 'pastoral' prestige structure, centering on community engagement rather than on professional purity." (Suchman, 2000: 93)

Second, although the Silicon Valley law firms practiced general law that did not meet all the needs of their new clients, the strong personality and entrepreneurial spirit of

[14] For example, in 1989, according information gathered by this author: "...Palo Alto, with a population under 60,000, has over 1000 lawyers practicing within the city limits –perhaps the highest ratio of lawyers to population anywhere in the United States outside Manhattan and perhaps Washington, D.C. What initially drew these lawyers to Palo Alto, at a time when it seemed so unlikely a starting place for careers? There is no single answer" (Friedman, 1989: 555) Friedman adds that lawyers interviewed had only one subject in common. They considered that Palo Alto offered a high quality of life: "But for whatever reasons, these lawyers defined Palo Alto as a distinctive and desirable community; this shared sense of the place has helped to make it a distinctive legal community as well, which Palo Alto's boosters praise over Bay Area rivals San Francisco and San Jose. When Palo Alto lawyers make recruiting pilgrimages across the country, they still play up the Valley's lifestyle, as if the population, housing and traffic booms, and the sharp intensification of work life –the seventy- and eighty- hour week –around the high-tech industries, had never occurred" (Friedman, 1985: 556-557)

some attorneys made all the difference. John Wilson[15], Leo Ware[16], Larry Sonsini[17] and Craig Johnson[18] stand out among those attorneys. The following quote from John Wilson further underscores this point:

> "Because [we] had been in big law firms…we did think that given an opportunity we could develop whatever expertise necessary…[O]our first client that wanted to go public, we didn't think about sending it out to somebody else. We took it public ourselves. When it became important to struggle with complicated tax matters, why we recruited people out of the NYU graduate tax program…" (quoted by Friedman, 1989: 560)

Finally, a third hypothesis promulgated by Friedman is: "Lawyers reacted to the high-tech boom, but they also helped to shape it." (Friedman, 1989: 561) Friedman was certainly visionary in that assertion. When, as of 1994, there was no longer talk of a "boom" but rather a true big technological bang owing to the advent of the commercial use of the Internet, there was no longer any doubt that Silicon Valley law firms were contributing innovatively to shaping the technological development of the region through what would be known as *venture law* or the Silicon Valley Lawyer Model.

Indeed, these lawyers realized that most entrepreneurs did not have enough experience in organizing businesses, working with venture capitalists or negotiating deals; nor did they know how to develop an efficient business plan, how to recruit a team, what kinds of incentives they should offer to their employees, how stock option plans worked, how to protect their intellectual property and myriad other fundamentally legal business

[15] John Wilson and Larry Sonsini founded the firm that would become the most influential in the region: Wilson, Sonsini, Goodrich & Rosati (see www.wsgr.com).
[16] See www.gcwf.com
[17] See Gupta, Udayan, *Done Deals. Venture Capitalists Tell their Stories* (Boston: Harvard Business School Press, 2000: 211)
[18] See the case study in section III D) of this first part.

issues. As a result, lawyers in the Valley realized that they should become more than lawyers to their clients. They decided to immerse themselves in the clients' businesses and work with them as partners. In this way, entrepreneurs were able to take advantage of the business experience and networking capacity of the lawyers[19].

Silicon Valley corporate lawyers also took into account the fact that entrepreneurs normally did not have money enough to pay expensive legal fees. Therefore, lawyers built a sophisticated fee framework: they decided to share in the risks that their clients took. Generally speaking, the strategy consisted of charging clients only a minimum fee to cover operating expenses. But, in addition to this small investment, lawyers asked entrepreneurs for stock in exchange for their legal services. In this manner, lawyers and clients legally became partners. As a result, the lawyers succeeded in becoming part of the company ownership structure. This structure is analyzed in detail below.

Although the Silicon Valley Lawyer Model empowered the professional relationship between lawyer and client as their interests were aligned, some ethical issues emerged. Since the same law firm often represented venture capital funds and entrepreneurs looking to raise money from these funds, a conflict of interests often occurred (McAlpine, 1999). Lawyers could not represent venture capital funds' interests and new venture initiatives in which they also held stocks. However, Silicon Valley lawyers began to behave flexibly "in their interpretation of the ethical guidelines governing the provision of

[19] It is interesting to review some of the way Silicon Valley law firms present themselves in their websites. This exercise provides an accurate idea on how these firms perceive to themselves. Certainly, this perception goes beyond that merely being legal services providers. For instance, Wilson, Sonsini presents itself as: "Your Strategic Business Partner"; Venture Law Group's website shows different statements from outstanding clients, who acknowledge how the law firm contributed to the success of their companies.

legal services to parties with opposing interests." (Suchman, 2000: 92) This flexibility has allowed lawyers to act as dealmakers between inventors and entrepreneurs, enhancing the trust among the players and building a successful community of interests. Nevertheless, the problem of the conflict of interests is more complex and involves some traits that deserve to be analyzed in detail. That analysis is made below.

B) The Search for Money

An entrepreneur who needs financing to launch a new company that either develops new technologies, or uses new technologies in a significant part of its business model, confronts the following dilemma: (a) should it resort to traditional sources of financing, such as banks or other financing institutions? or (b) should it resort to non-traditional sources of financing, such as private investors who contribute capital?

If the entrepreneur opts for the first alternative, it will be difficult for him to secure financing appropriate for his needs. As a matter of fact, banks and other financial institutions do not usually grant sufficient loans. Second, these entities only lend money when the loan can be secured by pledges, mortgages, collateral signatures, sureties or solidary debtors in general. Finally, although the financing may be granted, it is common for the loan installments to be accelerated before the new company breaks even, thus creating a liquidity problem. Consequently, it is not a reasonable option as the company will start out with a complicated financial burden.

On the other hand, the second alternative is complex. First of all, it is not an easy task to raise money from private investors (Sherman, 2000). It implies hard work and persistence in order to present an original business plan that will be profitable in the short or medium term (Sherwin Jr., 2000). Second, the entrepreneur needs access to those investors and that access is usually extremely difficult given the level of demand for capital and the few investors willing to provide it. Third, the entrepreneur needs negotiating skills that will allow him to keep control of the company even if he gets the financing he hopes for. Fourth, the entrepreneur must incur certain significant costs as private investors will normally perform a due diligence process (Lipman, 1998). Finally, the entrepreneur must put together a task force in whom the investors trusts, which involves recruiting highly skilled people who will expect salaries that match their skills (Quindlen, 2000).

Even if the entrepreneur believes that these initial obstacles can be overcome, he must make another decision: what type of investors does he want for his company? There are three alternatives. The first option is to raise money from different individuals who contribute small sums in different proportions. Normally, these funds come from family members and friends. The money is added to what the entrepreneur himself already has. The second alternative is to resort to a sound economic group that believes in the project and is willing to finance it (these are sometimes called the "angel investors").[20] And the third alternative is to raise money through venture capital funds. In the early stages of the project, the entrepreneur needs seed capital, so he frequently chooses between the first two

[20] This expression is also used in certain literature to refer to the case mentioned in the first option.

options or a combination. Once the company is doing business, it is more feasible to attract venture capital (Gompers and Lerner, 2001).

The principal advantage of non-traditional forms of financing a new company, as compared to traditional forms, is that there is capital debt in proportion to the interest of each investor in the equity capital of the new company instead of interest-bearing debt.[21]

C) Silicon Valley's Law Firms

As outlined above, the Silicon Valley law firms, which are members of a community in which the interests of entrepreneurs, investors and lawyers converge, knew how to adapt and give shape to a form of law practice that combines innovation and investment. In fact, Silicon Valley lawyers were sufficiently visionary to change drastically the traditional business model of U.S. law firms, take on major risks and, ultimately, reap extraordinary benefits (Johnson, 2000).

The Silicon Valley Lawyer Model is, in and of itself, a positive feedback process or a virtuous circle. That circle can be described step by step. Entrepreneurs work on the development of an innovation either in a product or service. They then need to start up a company to market that product or service. They explain their innovation and the earnings it can generate in a business plan that seeks to raise capital from non-traditional sources. However, as said earlier, access to those capital sources, in particular venture capital, is

[21] The non-traditional forms of financing also have disadvantages, but there is no room to mention them here. Some information on the subject can be found in Bagley and Dauchy, 1998, chapters 6 and 8. Regarding the advantages and disadvantages of venture capital, see also Southwick, 2001.

extremely difficult because the new technological innovation is very aggressive and there is a lot of competition. Nonetheless, the Silicon Valley law firms usually have the principal investors in the region in their customer portfolio or they at least maintain good personal relations with key individuals in investment funds. Consequently, the law firms can then act as a bridge between the entrepreneur and investors (Johnson, 2000). In this context, law firms, aware of the value that their client network and contacts, then decide to present themselves not only as providers of legal assistance, but also as the port of entry to venture capital (Suchman, 2000). Law firms have also realized that entrepreneurs are seeking capital but cannot afford to pay high legal fees. Hence, the law firms decide to collect just a small fee from the entrepreneur to cover operating expenses or, at times, they postpone fee payment until the entrepreneur has received capital. Since this creates a risk for the attorneys, they are careful to select only the top business plans of the entrepreneurs who seek out their services (Suchman, 2000). Once they receive these entrepreneurs as clients, law firms tend to request shares or stock options in the new company in exchange for services. Economically, this is the same as saying that lawyers invest in the new company by providing legal work. In this way, the entrepreneur and the lawyer become partners and together seek capital. The law firms know how to secure that capital because they have the clients or contacts with investors. From the investor viewpoint, investment by their attorneys in the project is sufficient guarantee of seriousness and they will often contribute capital for that reason alone. Thus, the interests of the entrepreneur, the law firm and the investors come together and all conflicts of interests disappear as everyone is pursuing the same goal: the success of the new company in which they have invested.

In other words, the law firm acts as a "*dealmaker*" in the venture of its entrepreneurial client. This is not a novel concept, as law firms have frequently acted as dealmakers. However, the novelty lies in that law firms are assuming a high risk. They are also investors in the project and the outcome is important to them. For that reason, law firms not only render high-quality legal counsel but, moreover, the entire firm is highly committed and accessible to the entrepreneur and willing to contribute more time to the new initiative (Johnson, 2000). Entrepreneurs will thus see their attorneys as true business consultants (Suchman, 2000; Johnson, 2000). Lawyers are no longer perceived as a transaction cost but rather become venture lawyers who practice venture law (Bernstein, 1995).

The practice of venture law supposes that law firms perform certain essential functions. Suchman has made a serious effort to organize those functions systematically. He asserts that venture lawyers act as dealmakers, counselors, gatekeepers, proselytizers and matchmakers (Suchman, 2000).

Venture law firms first act as dealmakers. As in the Wall Street Lawyer Model, this is a feature that generally characterizes the work of large law firms. However, with regards to Silicon Valley law firms, the meaning is more precise. Venture lawyers are intermediaries between entrepreneurs and investors who have a stake in the outcome. In fact, since the law firms hold shares in the companies owned by their entrepreneurial clients, the successful search for capital is an essential objective in the Silicon Valley Lawyer Model. If they fail in their attempt to raise money for the client, the law firm itself

is exposed to a significant loss of profit and credibility. Said otherwise, the firm is not indifferent to the results of its intermediation.

From another viewpoint, the fact that attorneys act as dealmakers is important to investors as well (Woolsey, 1996). Investors, and venture capital funds in particular, usually bear a heavy workload in their analysis and evaluation of business plans presented to them by all types of entrepreneurs. The selection process is thus an arduous task. Therefore, when the law firms are the ones presenting a potential deal, investors make a positive presumption in favor of the entrepreneur since it is clear that the law firms would not have invested in new ventures in which they did not see a clear opportunity to earn significant profits.

In this way, in Silicon Valley, lawyers are the first step in the acquisition of venture capital funds by entrepreneurs. Yet, at the same time, lawyers allow venture capital funds to find good new initiatives in which they can invest. Therefore, lawyers act as key intermediaries because they network on both sides of the table. Suchman describes this situation clearly:

> "Significantly, the law firm's dealmaking role affects investors as well as entrepreneurs. Indeed, some venture capitalists seem almost as concerned about whether lawyers will refer deals to them as entrepreneurs are about whether lawyers will give them an entré into the financial community." (Suchman, 2000: 81)

Venture law firms also act as counselors. Lawyers are not limited to providing legal counsel only but also provide a very particular type of business advice. Like their role as dealmakers, it is partisan work. The law firm wants its client to be successful and clients

lack the knowledge to manage a company on their own. Entrepreneurs are normally inventors of new technologies and not managers. Craig Johnson, one of the most outstanding lawyers of Silicon Valley, has explained how lawyers have dealt with their client's lack of business knowledge:

> "Although start-up lawyers in Silicon Valley draft documents and follow form…[T]hey usually play a much larger role in the businesses being started. They are often dealing with people with very limited or no business experience. These people need help in defining and pursing their business goals. They can go in many different directions and have many questions they need answered. Should they leave their present jobs or can they work on their new company idea while remaining with their current employers? How should the founders divide the initial stock ownership? Who should be on their board of directors? Whom should they use as patent counsel? Which financing sources should they consider? At what valuation and on what terms? Is their business strategy sound? How should it be modified? What should they do first? Second? Not at all? The start-up lawyer is writing on a clean slate, and there are no clear rules." (Johnson, 2000: 328)

A further reason why attorneys, rather than consulting firms, provide business advice to the entrepreneur is that in the early stages of a business, entrepreneurs are financially unstable and they are unable to seek advice from consulting firms. As a result, lawyers take on that role.[22]

Now, as we have seen, lawyers become necessary as dealmakers and counselors. These roles are certainly the most important ones. Nevertheless, subordinate to those roles are other more specific functions (Suchman, 2000).

Since Silicon Valley is a region with limited financial sources and since lawyers can introduce entrepreneurs to these sources, approaching a law firm is the first step that an

[22] Suchman asserts: "In itself, the assertion that lawyers act as counselors should come as no surprise. What distinguishes Silicon Valley practice from the image of large law firm practice in much of the recent literature, however, is the fact that in Silicon Valley, successful attorneys see themselves as offering general business advice, rather than purely legal guidance. Repeatedly, and across a wide variety of contexts, Silicon Valley lawyers describe an advisory role that closely resembles the work of more conventional business consultants." (Suchman,, 2000: 82)

entrepreneur must take. As a result, lawyers are also the ones to do the first screening of their clients' business models and business plans. Thus, lawyers act as gatekeepers. If they deem an entrepreneur's project potentially successful, then lawyers may accept the entrepreneur as a client and negotiate a venture law contract. In Suchman's words: "As gatekeeper, Silicon Valley lawyers use their dealmaking powers to construct and defend moral boundaries, guarding against interlopers who might disrupt emerging community understandings." (Suchman, 2000: 86) In other words, attorneys have become the guardians of the community of interests that characterizes the region[23].

Additionally, law firms also act as proselytizers. This means that the firms use their business advice to promote certain types of transactions and discourage others. For example, lawyers tend to persuade their clients that it is better to contract with venture capital funds than to resort to other types of investors or traditional forms of financing. Attorneys also usually set down appropriate standards for employee stock option plans. Certain clauses in investment contracts or in stockholder agreements are added by attorneys as a guarantee of equity. That advice and other similar counsel has created certain a set of informal standards that serves to guide others as to what is appropriate or inappropriate within the Silicon Valley community.

Finally, law firms also act as matchmakers. The idea behind this function is simple. As lawyers make more and more deals between entrepreneurs and investors, they develop a

[23] To a certain extend one may affirm that lawyers failed as gatekeepers. They should have been able to predict the burst of the Internet bubble and they should have acted carefully after April 2000. However, both venture capitalists and venture lawyers kept on investing in overvalued companies after the drop of NASDAQ. Why? This is certainly something that has to be studied.

particular expertise in determining who is appropriate to do business with whom--which entrepreneur, what product or service, which personalities get along better with the different profiles and preferences of investors. Suchman describes this function quite precisely:

> "... Silicon Valley culture stresses the importance of cooperative relationships between entrepreneurs and venture capitalists; given this, finding the right mate takes on heightened importance. In this climate, law firms often help to facilitate 'good marriages'. This organizational matchmaking role has three parts, much like traditional romantic matchmaking: First, matchmakers (both romantic and organizational) winnow out 'ineligible' clients, who are so deviant either ethically or structurally that representing them would besmirch the matchmaker's reputation; here, the matchmaker acts primarily as a gatekeeper. Second, matchmakers formulate typologies of clients and encourage those who are seeking partners to conform to certain culturally approved models; here, the matchmaker operates much like a proselytizer. Finally, and most distinctively, matchmakers employ cultural 'rules of compatibility' to sort their clienteles, arranging matches between "likes" and discouraging contact between "unlikes." (Suchman, 2000: 89)

As we shall see below, this is the key to the analysis of potential conflicts of interest.

Fee Structure

It has been repeatedly affirmed throughout this paper that all entrepreneurs need capital. And they must negotiate with investors in order to obtain that capital. Those negotiations are important because investors, in particular venture capital funds, wish to obtain preferred shares that give them control of the company or at least a seat on the board of directors. Consequently, the entrepreneur, who normally lacks the abilities of a good negotiator, and is ignorant of laws governing the transaction, must hire an attorney. This poses a new financial problem: How to pay for legal fees? Additionally, as one author points out, even when the company has already raised sufficient money to do business and

has therefore begun a growth process, legal problems may arise from a violation of intellectual property rights. Should that be the case, the company will require a litigating attorney to defend its interests in a lawsuit and it will again face the problem of attorneys' fees (Miller, 2000).

For these reasons, many law firms in Silicon Valley specializing exclusively in startups, have invented different models for payment of their fees. The most interesting and novel of those models is a request for shares in the client's company in exchange for legal counsel. Thanks to this innovation by attorneys, a social loss has been prevented – economically speaking –, which would have occurred if the entrepreneurs had not had the opportunity to develop their ideas due to a lack of initial financing to cover legal expenses.

Law firms who have chosen to take the risk of supporting entrepreneurs have developed three different fee payment models (Miller, 2000). Those models can be combined, and one single law firm may use any of the different fee payment models, depending on the client.

The first model is called the *straight investment model*. Under this model, the law firm buys shares in the client and also collects non-adjustable fees per hour that it works for the client. In other words, since the firm is contributing money to the client's company by way of capital, the client must allocate part of that revenue to the fees for legal counsel. This is the model most commonly used.

The second model is called the *deferred billing model.* Under this model, the law firm postpones the payment of the client's fees but requests an option to invest in its company in the future at a pre-set price. This model poses several questions. As Miller asserts:

> "...for example, how does this higher collection-uncertainty affect a law firm's representation of the client from the period when they accept the client to the time when the client obtains sufficient funding? While one might expect that the law firm would be more conservative in bargaining with venture capitalists because it only wants to ensure that there will be sufficient capital to pay the firm for its services, the opposite might actually be true. The law firm's position could be influenced by the amount of risk it is willing to accept in this particular venture, and if it has a diversified investment portfolio or has enough "cushion" in the form of other reliable clients, it may be willing to be very aggressive in trying to secure a "home run" deal in this particular case (because it will later receive stock that could benefit from such a deal)." (Miller, 2000: 444-445)

Finally, the third model is called the *stock-as-fees model*. Under this method, the law firm receives stocks or stock options for legal counsel instead of money. Sometimes, the law firm also collects very low fees to cover its operating expenses. This occurs when the law firm receives only stock options instead of stock in which the option is exercisable at a substantially lower price.[24]

However, one of the matters that has been debated lately is why only law firms, and not other professionals, use the models described above, to interact with the entrepreneur.

[24] Miller has analyzed this model in detail. According to Miller: "…the stock-as-fees model involves some unique issues. For example, a law firm that takes stock in lieu of cash is not waiting to collect its fees until the client obtains financing or completes the underlying transaction. Instead, the law firm has already collected. Again, this can change the incentives of the law firm throughout the lawyer-client relationship because the firm may be thinking not only as outside counsel, but also as an investor. Here the stock-as-fees model takes on two different characteristics. On the one hand, because the law firm has already received the securities, there is an element of typical hourly or flat-fee billing. While the value of the stock to the firm is by no means certain, the firm will be able to count on some minimum stock value. On the other hand, these uncertainties could be very large in some cases. In such situations, the stock-as-fees model looks more like a contingent fee arrangement, whereby the law firm will only receive payment if the company actually succeeds (in its IPO, its financing, or in its venture more generally)." (Miller, 2000: 445)

The answer seems to lie in the special relationship between the lawyer and the client. This relationship would not develop in other cases. Miller points out:

> "There are distinctions, however, between the lawyer-client relationship and the relationship between the company and its other suppliers and service providers. The dearth of such agreements within the latter group is explained by comparing bargaining costs with (1) the typical duration of the purchaser- supplier relationship, particularly in the dynamic high-tech industry and (2) the benefits the supplier can obtain from its increased opportunity to monitor the venture. Whereas the start-up company is likely maintain its relationship with its outside legal counsel for a considerable time -- e.g., because the law firm will help the company navigate the VC funding process and will help it structure its business in anticipation of a possible public offering -- the company's relationship with suppliers may be more transitory. This is true of both large and small suppliers because the dynamic nature of the high-tech industry requires the formation of new alliances and contracts to stay competitive. Because granting an equity interest to an outside party implies an increased level of interaction between the company and its passive shareholders, the costs of negotiating these more complicated transactions, and the costs of maintaining the relationship after the stock has been transferred, often will prove prohibitive in relation to the benefits obtained." (Miller, 2000: 446)

In other words, the lawyer-client relationship tends to last longer, and since the law firm is a shareholder in the client's company, the lawyer has a clear incentive to oversee the administration of the company, in keeping with the limitations of professional secrecy. The relationship of mutual trust that usually exists between the lawyer and his client encourages this type of transaction. This does not necessarily occur in other types of commercial relationships.[25] A supplier of goods and services does not feel any bond of trust to a new company it delivers to, and furthermore, does not expect to monitor that company's business practices (Miller, 2000). In summary, according to Miller; "... companies typically grant equity interests to parties who are likely to have a long-term relationship with the company and to parties that can make a significant contribution such that the greater incentives provided by ownership interests justify the initial bargaining costs and the on-

[25] Miller observes that: "Perhaps the accountant-client relationship is an analogous fiduciary context. However, accountants are forbidden from taking equity interests in their clients by the American Institute of Certified Public Accountants ("AICPA") ethical rules and SEC independence requirements." (Miller, 2000: 446)

going equity ownership control. Likewise, parties with superior monitoring opportunities and with opportunities to control the direction of the venture are most likely to accept stock or other forms of equity." (Miller, 2000: 449)

The Problem of the Conflict of Interests[26]

As analyzed above, Silicon Valley lawyers who practice venture law usually take an interest in the capital of the companies they counsel. That tendency may create two types of conflicts of interest. The first type of conflict occurs when the law firm simultaneously represents the interests of investors (including the firm itself) and the interests of the client-entrepreneur. The second type of conflict occurs between the law firm and its client-entrepreneur only. In the first type of conflict the law firm represents one or more additional investors in the new venture while in the second case, the focus is only on the relationship between lawyer and client.

These two types of conflicts are difficult to resolve and pose complex ethical questions. For that reason, the question is whether these conflicts should be regulated in some way or whether the matter should simply be resolved through the interaction of the social players involved in the transaction. For purposes of analysis, I will begin in inverse order. I shall first analyze the second type of conflict and then examine the first. The

[26] Venture law practice may also apply to real estate business and litigation. It is something that is not analyzed in this paper. Mitchell Polinsky and Daniel L. Rubinfeld have developed an interesting theory on how to resolve the conflict of interests in the litigation area, particularly with respect to the economic analysis of contingent fees. See *Aligning the Interests of Lawyers and Clients,* forthcoming in the American Law and Economics Review.

reason behind this order of analysis is purely methodological: the first conflict is easier to resolve after answering the problems posed by the second.

Should lawyers be allowed to invest in their clients' stock? Gwyneth E. McAlpine has written on of the most relevant articles on this issue, and has accurately anwered the question. The McAlpine's theory is points out:

> "...certain equity investments, namely, investments in growth-oriented companies that compete for venture capital, do not present a situation in which adherence to the professional responsibility requirements is needed to protect the client. Norms within this community limit the range of terms of the equity investment and tend to align the interests of the shareholders and the company." (McAlpine, 1999: 549)

McAlpine also argues:

> "...that the investment is beneficial not only to the lawyer but also to the client and to start-up community as a whole. The significant benefit to the client suggests that the investments should continue; thus, ease of transacting should be preserved. Because the lawyer has an incentive to continue the transactions, he will adhere to the terms acceptable within the community. In addition, the lawyer must adhere to his fiduciary duties to his client, even in the absence of specifically applicable professional responsibility rules. Between the community standards, aligned interests, and fiduciary duties, the typical equity investment in a growth-oriented company by a lawyer will advance, rather than conflict with, the client's interest." (McAlpine, 1999: 549)

Finally, McAlpine concludes:

> "… that in this scenario, the added requirements of the professional responsibility rules are superfluous; the incentives of both parties to transact and the norms set by the start-up and venture communities serve to protect and promote the client's interests." (McAlpine, 1999: 549)

It is relevant to examine how the author reaches these conclusions.

Normally, a conflict of interest may arise when a law firm invests or takes on shares in its client's capital in exchange for professional services. This enables the lawyer to gain

an illegitimate advantage over the client because of the legal knowledge the lawyer has that the client does not. In fact, the lawyer's acquisition of capital in the client is considered a business transaction between the lawyer and the client. Therefore, that transaction is subject to the rules of professional ethics established by bar associations.[27] Codes of professional ethics and general principles on the matter usually stipulate a presumption in favor of the client in the event of conflict. Since it is presumed that the lawyer is in a better bargaining position than his client; it is further presumed, in the event of a claim by the client, that the lawyer acted with "undue influence" and, therefore, the transaction may be voided and the lawyer sanctioned. Under this scenario, the lawyer must prove that he acted within the limits imposed by his fiduciary obligations.[28] As McAlpine points out:

> "To rebut the presumption of undue influence, the lawyer must show that he acted in good faith, that the transaction was fair to the client, that there was full disclosure of the lawyer's interest, and there was no overreaching or fraud by the lawyer. Because of the fiduciary relationship, the burden is on the lawyer to show compliance with these standards. Given the high standard to which the lawyer is held, this can be difficult." (McAlpine, 1999: 560-561)

[27] As McAlpine summarizes: "Business transactions between lawyers and clients are governed by two sets of rules: the disciplinary rules adopted by bar associations and the common law principles of lawyers' fiduciary obligations to clients. The ethical standards promulgated by the bar are largely embraced by state legislatures and the court system. Most states have adopted the American Bar Association's Model Rules of Professional Conduct (Model Rules); some have retained its predecessor, the Model Code of Professional Responsibility (Model Code). These standards provide for disciplinary action by the bar for violations. California, where the most venture activity occurs, has a unique set of rules." (McAlpine, 1999: 558 -559). In any case, the rule related to business transactions with clients is substantially similar to the Model Rules, therefore, for the purposes of the analysis made by the author, the "unique" character of the California ethical rules of the legal profession is irrelevant.

[28] Additionally, codes of professional ethics require that a specific formal procedure be followed when there is a transaction between a lawyer and a client. The requirements include the duty to make a full disclosure of the transaction and obtain the client's consent. Although there are some differences between the Model Rules and the Model Code, ultimately they are insignificant. McAlpine affirms in this regard: "In a Model Rules jurisdiction, however, disclosure and consent must both be in writing, and the lawyer must recommend that the client seek independent counsel. Also, the transaction must be fair and reasonable to the client. Yet, regardless of the wording of the statute, fairness would be an issue because the attorney has a fiduciary obligation to his client. Thus, although the language of the Model Rules is more stringent than that of the Model Code, both approaches hold the lawyer to a similarly high standard of conduct." (McAlpine, 1999: 563)

The lawyer – client transaction is thus subject to regulations that obligate the lawyer to conform to professional ethical norms. But are these regulations necessary? McAlpine's theory holds that they are not.

According to the author, there are sufficient incentives for both parties to act ethically and cooperatively. Therefore, the regulations are superfluous. On one hand, the client can obtain significant benefits from the investments made by his lawyer in the company. A new company has a lot to gain from the legal and business advice of its law firm and the law firm takes a leap of faith in investing in the client's new venture. Both share the risk of the initiative. Additionally, the client acquires capital thanks to the investment from the law firm. On the other hand, by investing in his client, the lawyer can obtain significant profits, which mitigate the risk inherent to representing startup companies. In so doing, lawyers foster entrepreneurship. Lawyers accept "a wider range of clients and support the entrepreneurial spirit of venture-funded companies. The high-technology industries have flourished under a system in which lawyers are willing to absorb the financial risks and uncertainties of start-up companies. Thus, the positive effects of the investment transactions go beyond the benefits to an individual client. They can economically assist an entire industry." (McAlpine, 1999: 565) The author is even more emphatic in her reasoning:

> "Because of the potential for far-reaching benefit, these transactions should not be discouraged by professional responsibility rules in cases in which they do not produce a significant conflict of interest. First, discouraging them does a disservice to the client the rules are intended to protect. Start-up companies rely on lawyers to help them gain access to venture investors and business advisors and to give them a sense of the community standards. Lawyer investments are conducive to this because the lawyer's equity stake gives him a greater incentive to act as an advisor to his client outside the scope of his legal services. Second, deterring investments can harm community entrepreneurship as a whole because it eliminates a means for lawyers to absorb risks of start-up

companies. Without a means to mitigate risk, lawyers might be less willing to represent start-up companies." (McAlpine, 1999: 565-566)

The author denies that the client is in a disadvantageous position with respect to the lawyer. In these types of investments, the client has the protection of the community. The venture community, formed by entrepreneurs, lawyers and investors, establishes its own informal rules of good behavior. Since the reputation of the law firm is essential to continuing in that community in the future, lawyers have significant incentives not to take undue advantage of the client's business. The client wants access to non-traditional sources of financing and successive rounds of fund-raising. If the lawyer imposes abusive conditions on the client, it may be difficult to raise additional capital in the future. The law firm will also be mistrusted by investors, who will exclude the clients of that firm from their potential investment portfolio. Fewer entrepreneurs will seek advice from the abusive law firm since they earn no profits, and might even lose them. In summary, taking advantage of the client is the worst move a law firm can make and, therefore, there are strong incentives to behave according to the standards established by the community. If this were so, it is easy to conclude that the regulations seeking to protect the client from potential conflicts of interests with their lawyers are redundant and superfluous.[29]

Thus, the second type of conflict of interests posed above seems to be resolved. However, the problem posed by the first type of conflict of interests must be faced. This conflict is the one that can occur when one same law firm that has invested in a new

[29] And they also increase the transaction costs. If lawyers must follow the procedures indicated in codes of professional ethics, which implies several formal acts, that conduct will increase the transaction costs. Those costs are then transferred to the client, making the entire transaction unnecessarily expensive.

company simultaneously represents that company and one or more of the investors contributing capital to the venture. As said above, this problem is simpler to analyze after resolving the previous one. The same rules apply except that the client-lawyer relationship is in this dual context. The resolution of the conflict lies in finding the way to align interests and introduce limits on the actions of the law firm.

In determining how to align interests, it is useful to identify what each of the parties involved in the transaction wants. The entrepreneur wants capital. The investor wants to invest in a highly profitable project. The law firm wants the entrepreneur to be successful in earning significant profits. It is reasonable to assume, consequently, that every one wants the business to be successful. When thus presented, the interests seem to converge. The entrepreneur and the law firm will reach a reasonable agreement for the reasons explained above. After that agreement is formed, together they will submit the development plan for the new company to investors. The role of the law firm then becomes more complex since it is evident that the entrepreneur will want his lawyer to negotiate the transaction with the investors as efficiently as possible in order for control of the venture to remain at all times with the entrepreneur. But investors who are assuming a high risk will also want a certain degree of control over the project, seats on the board of directors, some authority of administration and oversight. Therefore, investors will require the law firm to negotiate those objectives. So, the law firm now faces a dilemma: how can it fulfill its duty to act in the best interests of the client if both parties are its clients? That situation is at times simply impossible to resolve because of the nature of the players involved (some investors and entrepreneurs are more aggressive than others). Accordingly, in those cases,

some law firms have chosen to focus solely on assisting entrepreneurs and others solely on assisting investors since they consider the conflict to be irresolvable. However, other law firms have taken on the challenge of resolving the conflict. These latter firms have standardized the structure of these transactions so that negotiation is as limited as possible. McAlpine asserts in this regard:

> "Because of the narrow range of terms in venture financing and the commonality of interests between companies and investors, transactions tend to be almost standardized within the venture community. This tends to institutionalize the expectations of the community. Not only will parties work within the narrow range of terms in transactions with venture capitalists because they demand it, but the same narrow band of terms will also be applied to transactions within the venture community in which venture capitalists are not even involved. This is because the standardization benefits all players in terms of reduced transaction costs and reduced uncertainty, and because the standard terms promote the interests of both the investors and the company. Furthermore, companies in earlier stages of financing do not know yet whether they will be the ones who succeed in securing venture backing or the ones who falter. Thus, they gear the terms of their financings towards what a venture capitalist or other investor, who enters the picture at a later stage, will want to see. Companies cannot exist too far outside the range of what everyone else is doing and still expect to attract the same investors and advisors" (McAlpine, 1999: 590)

This paragraph shows how limits on the behavior of lawyers can be found. Those limits are the same that apply to the conflict analyzed first, i.e. those that impose informal rules developed by the venture community. If the law firm exceeds those limits, it will not survive in the venture law business.

D) Case Study: Venture Law Group[30]

One of the law firms most representative of the type of law practice described above is Venture Law Group ("VLG"). And the best way to prove this assertion is what the Wall

[30] Almost all the bibliography consulted for analyzing this case study has no page numbers, that's why in the text only the author and the year are mentioned.

Street Journal affirmed in March of 2000: "By conventional standards, Venture Law Group would seem a case study on how not to run a law firm." (Schmitt, 2000). The name of the firm itself is an innovation. Law firms are usually recognized by the names of the founding partners or senior partners. But in the case of VLG, the name of the firm is determined by its business model: venture law practice. VLG was founded by Craig Johnson in 1993. In less than ten years, VLG has become one of the leaders in Silicon Valley, and Johnson is now one of the most important and influential lawyers in the region.

The corporate history of VLG is fundamentally linked to the personality of its founder. Craig Johnson is highly creative, and has an entrepreneurial outlook. To understand VLG one must understand part of the biography of Craig Johnson. After graduating from Yale University, Johnson volunteered for the Peace Corps and worked in Ethiopia. He later worked as a computer programmer. He studied law at Stanford Law School. In 1974, Johnson joined the law firm Wilson, Sonsini, Goodrich & Rosati, located in Palo Alto, which at that time consisted of no more than 12 attorneys. In 1980, Johnson became a partner in Wilson, Sonsini. Nevertheless, and this reveals his personality, he decided to leave the firm in 1993. That was something that no one at that time was capable of understanding as Wilson, Sonsini was, and continues to be, one of the most important law firms in California.[31] Johnson left the firm because its partners did not agree to follow the business model he had in mind. Due to that difference of opinions, Johnson and fifteen

[31] See www.wsgr.com.

other attorneys launched the VLG project on their own. That was the start of the controversy created by Johnson in Silicon Valley.[32]

In constructing the VLG business model, Johnson was very clear about two things he had to do. First, he had to create a law firm that would not replicate the defects of existing law firms; and second, he had to devise a totally innovative corporate structure and law practice.

With regard to the first of these two elements, Johnson had observed over the years how partners in large and mid-sized law firms earned money at the cost of their associates. The partners basically worked as rainmakers, meaning they brought as many clients as possible to the firm. Associates, in turn, had to practice most of the law. Additionally, the marginal cost of retaining an associate was relatively low. The annual salary of an associate was quite lower than the annual earnings of a partner. As a result, since associates were those who actually rendered legal service and there was substantial demand for those legal services on the part of clients, the profits earned by associates based on the large number of hours worked far exceeded the cost of their salary.

The VLG business model changed that structure. First of all, Johnson changed the name. There are no "partners" or "associates" in his firm but rather "directors" and

[32] Osborne points out that: "Johnson claims that the idea for VLG came to him in a dream in early 1993. For months he had been frustrated in his efforts to set up a Wilson, Sonsini satellite office on Sand Hill Road. He'd been worried, too, by turnover and growth at the firm, which in his time had expanded from 10 to roughly 250 lawyers. That growth –accompanied by expansion and maturation of the companies on Wilson, Sonsini's client roster- had diluted the firm's focus on the early-stage companies that were Johnson's passion. His dream seemed to spell out a clear solution to it all…he says, he awakened from a deep sleep with a complete vision for a new business in his head. Before any of the details faded, he got out of bed and, still in his pajamas, wrote down everything. By dawn he had filled 15 pages." (Osborne, 1998)

"attorneys".[33] Second, VLG does not intend for its attorneys to work extremely long hours just to charge more and more hours to clients. Instead, most of the firm's profits come from the equity they take on in their clients. For that reason, VLG did not aspire to more than 75 lawyers. There are now 29 directors and the firm does not exceed 85 lawyers, directors included.[34] As Osborne points out:

> "VLG has flattened the traditional pyramidal law-firm model staffing, in which a cadre of newer lawyers works under the supervision of a few senior ones. Instead, VLG promises its clients that its big-name senior partners –lawyers like Johnson and his partners Joshua Pickus and Jim Brock- will be deeply involved in servicing the business. As an extension of that principle, VLG has elected to limit its lawyers to advising only 15 to 20 companies at a time (whereas at other law firms, individual partners may count 30 to 50 companies as clients." (Osborne, 1998)

And finally, but not least important, the work place and relations between lawyers must be comfortable and harmonic. VLG was one of the first law firms to set aside the formal jacket and tie in order to allow attorneys to dress casually but elegantly.[35]

With respect to innovations of substance in the VLG business model, the VLG website expressly sets down the difference between VLG and a traditional law firm.[36] Several publications and reports have emphasized the same characteristics. Craig Johnson has declared to the press: "We view ourselves as a mirror image of a traditional law firm.

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[33] As Guynn and Schuyler point out: "…VLG has hired some of the peninsula's brightest young starts from rival firms, has set up shop on Sand Hill Road within a quarter mile of 75 of the valley's most prominent venture capitalists, has attracted a heady mix of *Fortune 500* and start-up clients, and has turned the structure of a traditional law firm on its head with an inverted pyramid structure, high automation, and a novel profit-sharing scheme for attorneys and staff." (Guynn and Schuyler, 2000)

[34] See www.vlg.com. The information was obtained from the website on 02/29/02. VLG has also opened three small representation offices in San Francisco, the Pacific Northwest and Northern Virginia for specific purposes.

[35] For some analysts, the conception behind this idea is that work is also a place to have a good time. Under that focus, more efficient behavior would be achieved inside companies and they would be more productive as a result.

[36] See www.vlg.com.

Other lawyers who have checked out the firm's operations just shake their heads. Everything we are doing is contrary to their instincts." (Schmitt, 2000) Four features set apart the VLG business model from the model of a traditional law firm.

First, VLG specializes in representing clients for whom high technology comprises a significant part of their business model. VLG advises this type of client in the different stages of developing of the venture. In other words, VLG advises its clients from the time the company is merely a project, takes it through start-up and successive rounds of financing until the company makes its IPO and is taken over by another larger company, and in certain cases, even thereafter. The VLG website states in this regard:

> "We are experts in the legal specialties most early stage technology companies need, including venture capital financings, public offering, mergers and acquisitions, technology licensing and corporate partnerships, executive compensation and taxation. We have invested millions of dollars and thousands of attorney and paralegal hours in developing software and databases which serve our clients' needs and which are superior to those of any other technology law firm."[37]

Second, VLG is also innovative because the firm is the one to select its clients. Not just any entrepreneur or company can be a VLG client. The firm is the one to choose instead of the client. That is entirely new since attorneys are traditionally the ones who, almost desperately, try to bring clients to their respective firms. The rainmaker figure fits in that profile. However, VLG reverses the process. There are at least two reasons behind that decision: (a) VLG is trying to provide personalized, high-quality assistance to its clients so that they increase their likelihood of success. This requires the VLG lawyers to have a small client portfolio that will give them sufficient time to attend to the clients'

[37] www.vlg.com Visited in 02/29/02

needs; and (b) since VLG invests in the capital of its clients, it needs to ensure that its clients grow and generate profits as fast as possible. Therefore, only those clients with a high probability of success are accepted by the firm. These ideas underlie VLG website:

> "We don't try to represent every company. We choose our clients as carefully as they choose us and place strict limits on the number of companies each VLG attorney can represent. To our knowledge, we're the only law firm which does this. We want to represent clients where our brand of total commitment, partnership and expertise will add the greatest value."[38]

But VLG does not only choose its new clients. It also lets them go when they have made their IPO or when they have been taken over by a larger company. Nor does VLG provide all types of legal service but rather only those required for the incorporation and subsequent growth of its clients. As a result, through a strategic alliance, VLG recommends Orrick, Herrington & Sutcliffe, a more traditional firm, to its clients when they no longer require the services that VLG usually provides. The VLG website states in this regard:

> "From its beginning, VLG has wanted to remain small and to concentrate on providing the type of legal services which high potential technology startups need most - corporate, securities, tax, employment and intellectual property/licensing law. But we recognized that there are other legal services which are often needed by VLG clients as they grow which VLG has chosen not to provide - litigation, real estate, debt financing and other areas. We also realized that due to their rapid growth VLG clients could sometimes generate more work and projects than the VLG client team could handle well. In March 1999 VLG approached Orrick Herrington & Sutcliffe LLP about establishing a strategic relationship between our two firms. Orrick is a high quality, broad service, 500 + lawyer law firm that began in San Francisco more than 130 years ago and now has ten offices throughout the United States and the world (San Francisco, Silicon Valley, New York, Los Angeles, Washington, D.C., Seattle, Sacramento, London, Singapore and Tokyo). Orrick enthusiastically responded to VLG's invitation, and the relationship was consummated later that year. Both Orrick and VLG are committed to excellent client service, and we both saw an opportunity to create a new law firm business model which would serve both our needs and the needs of our clients. Orrick has licensed VLG's proprietary system of legal forms and annotations, to enhance consistency of the work product of both firms. Since 1999, VLG and Orrick have worked together on more than 100 different companies and projects. Senior management teams of Orrick and VLG meet monthly to discuss how to improve the services both firms provide. By combining the resources of a larger law firm with the startup expertise and focus of VLG, we think our clients get the best of both our firms. While our

[38] www.vlg.com Visited in 02/29/02

> relationship with Orrick is not exclusive, we feel our relationship with Orrick and our knowledge of the capabilities of the Orrick team often allows us more quickly to involve the right person for the project at hand. Each decision to involve Orrick is made by the client and VLG client manager."[39]

The large companies that Craig Johnson and other founding lawyers of VLG advised at the time VLG was launched were gradually rejected as clients in order to focus VLG solely on start-ups. "Specializing in Web Start-Ups, Venture Law Group Turns Its Back on Corporate Stars" was one of the subtitles chosen by Richard Schmitt, in his report on VLG (Schmitt, 2000)

The third and clearly most novel aspect of the VLG business model is its fee structure.[40] VLG charges fees only when its services add value to the client. And it usually postpones collecting those fees until the client is sufficiently funded so that it can make payment without affecting the course of the business. Under the VLG fee structure, clients are characteristically asked to issue shares in their company in exchange for legal counsel and business assistance. Normally, these are common shares, unlike the preferred shares

[39] www.vlg.com Visited in 02/29/02

[40] As Guynn and Schuyler point out, normally, large law firms charge their clients "for routine photocopying, long-distance phone calls, computerized research, and faxes, to name a few" (Guynn and Schuyler, 2000). However, what really bothers to clients is not to be charged for reasonable photocopying and fax costs. On the contrary, what they really complain about – to put this in Blane Prescott's words - is "it's when you are turning those into a profit center that it upsets them to the point that it can help drive them away." (Guynn and Schuyler, 2000) Mark Chandler – StrataCom's general counsel, has stated: "…law firms that insist on such billing practices are losing a competitive edge to equally qualified firms, like Venture Law Group, that make a point of *not* charging for the extras." (Guynn and Schuyler, 2000). Finally, Guynn and Schuyler provide a good description regarding the way in which VLG bills its clients. These authors say: "Each bill lists a description of the service performed, the attorney who completed the task, the date, the number of hours, and the billing rate. It also includes the amount of the previous bill, payments made to date, and the amount owed. A second part of the bill sums up the tasks performed and the amount charged per task." (Guynn and Schuyler, 2000) Everything is clear and in order so there are no miscellaneous items and, consequently, clients can understand better what exactly is being charged and why. This also allows clients to manage their budgets better. According to Guynn and Schuyler, VLG has been wise enough in this regard, as VLG has a 98 percent collection rate, while most firms average 90 percent. "Those percentage points make a big difference to the profitability of the firm," Craig Johnson says, and he adds: "They are also a great measure of client satisfaction. I still think that it's probably one of the best ways to figure out if you are doing a good job." (Guynn and Schuyler, 2000)

requested by venture capital funds who invest in subsequent financing rounds. The shares that VLG acquires through its clients are appraised at a low value because the value of the capital in a start-up company is still low. VLG or its lawyers also directly invest money in the new company when they see a high likelihood of success in the short or medium term. The percentage interest that VLG acquires varies from client to client. Although no official figures are available, a review of literature shows that VLG's investment in its clients ranges from 0.5% to 1.5% of the equity.[41]

These acquisitions and investments are legally channeled through a fund (VLG Investments) separate from the law firm, which is managed by VLG lawyers. Not only can VLG directors invest in clients but also the attorneys. By doing this, VLG maintains incentives for its attorneys to remain in the firm instead of emigrating to other law firms or going out to work directly as in-house counsel for its clients. As Miller points out:

> "VLG asks its start-up clients for the opportunity to buy into their businesses, purchasing common stock first and preferred stock after a company receives financing. All the firm's senior lawyers and partners contribute a pro rata share of their profits to VLG Investments, which in turn takes a small equity position in the firm's start-up clients. In addition, a partner responsible for bringing in a particular client also buys into the start-up personally. As a policy, VLG partners are required to take from 10% to 20% of the equity opportunity that VLG is offered in the client, with the remaining 80% to 90% reserved for the firm's fund. In this way, VLG, much like a VC firm, is concerned with the long-term success of its clients. Several factors combine to ensure that the client- lawyer relationship should be for a relatively long term and to ensure that partners will screen clients for profit-potential and investment risk very carefully: (1) the 10% to 20% mandatory investment by partners; (2) the fact that lawyers' investments in the fund do not vest for four years, thereby providing an effective

[41] Miller asserts: "…VLG's investments take the form of both common and preferred stock, and VLG (or VLG Investments) receives any dividends paid on the stock. Indeed, VLG enters into a stock subscription agreement similar to that of any other stockholder. VLG also requires a client to sign a "Conflict Waiver and Consent of the Company" statement informing the client of potential conflicts of interest, as required under California Rules of Professional Conduct. The form states that the client consents to VLG's participation in the relevant stock financing in which VLG also represents the client, and further states that the client is informed that it may seek the advice of independent counsel in connection with VLG's participation in the financing. With this approval, VLG then invests some amount in its client's offering, typically less than 1% of the total equity. As noted earlier, the investments are usually long-term, with VLG typically retaining the interest even if the lawyer-client relationship ends." (Miller, 2000: 441)

> tool for retaining lawyers; (3) the securities laws' requirement that investors purchasing pre-offering shares are bound by a typical lockup period that prevents investors from trading such shares within 180 days of the public offering; and (4) because most of the stock held by VLG is defined as "restricted securities" under Securities Exchange Commission ("SEC") rules, the firm is required to hold its pre-offering shares for at least two years after purchase." (Miller, 2000: 440-441).

Additionally, VLG also offers stock options plans to its paralegals and administrative staff so that all members of the firm benefit from the firm's earnings.

This feature – benefits for all - is one of the keys to the model's success as it keeps the interests of all employees aligned inside the firm, facilitates cooperation and teamwork and eradicates individualism and competition that typically occur in traditional firms. As it is well known, becoming a partner in traditional firms frequently causes problems with loyalty among the competitive associates (Galanter and Palay, 1991). Thus, VLG has its own corporate culture. Craig Johnson provided a copy of the book *Built to Last*, written by James C. Collins and Jerry I. Porras,[42] to each member of the firm, whether attorney or staff. This book tells the story of how eighteen U.S. companies managed to create a lasting business and generate millions of dollars in profits. Some of the characteristics common to all those companies are "core values" that Johnson considers essential to the success of any business. Johnson usually speaks of this book as the "VLG Bible". Johnson has said of the VLG corporate culture: "We value partnership and teamwork in working towards common goals and are not overly hierarchical or formal ... Family and fun are important to us" (Schmitt, 2000) The 2001 Vault survey of associates at 120 major law firms ranked VLG the third best law firm in the country to work for.[43] According to its website, VLG "emphasizes fun and family and sponsors many community events, including the Sand Hill

[42] See "References" of this paper.
[43] www.vlg.com, visited in 03/10/02.

Challenge and the Tour De VLG, which was led this year by three-time Tour De France winner Greg LeMond."[44]

Fourth and finally, VLG fulfills absolutely all the functions typical to venture law practice. Through its lawyers, VLG acts as a dealmaker, business counselor,[19] gatekeeper, proselytizer and matchmaker (Johnson, 2000). Johnson has declared that: "We're becoming a hybrid of a startup law firm, a venture capital firm, a consulting firm and an investment bank … We're moving into a zone of entrepreneurism that other firms haven't considered." (Orenstein, 2000) "VLG bills itself as one-stop-shopping destination for start-ups –equal parts management consultant, investment banker, venture capitalist and legal adviser." (Schmitt, 2000)

In summary, as Orenstein asserts: "Thanks to the wild and money-soaked growth of technology and Internet-related business, the legal world has been turned upside down: Big public companies are no longer desirable clients, associates are no longer peons, lawyers are no longer disinterested counselors, litigators are no longer starts and, the most striking reversal, in the lawyer-client relationship, clients no longer call the shots." (Orenstein, 2000) VLG is clearly a good, if not the best, example of this phenomenon.

[44] www.vlg.com, visited in 10/03/02

[19] Osborne points out that Johnson has said: "We have far fewer companies per attorney than our competitors…We prefer to concentrate on companies where we can provide business advice as well as legal advice. We like to be in the trenches." (Osborne, 1998). Also, VLG's website states: "We treat our clients as long-term business partners, combining excellent legal skills with good business judgment and playing an active role in helping our clients succeed. As our clients succeed in building their businesses, we will succeed too." (www.vlg.com, visited in 10/03/02)

PART II

LAWYERS AND ENTREPRENEURSHIP IN CHILE: Challenging the Way Chilean Lawyers Practice the Legal Profession

I. Chilean Economy: an economy without entrepreneurship. An Overview

The history of the Chilean economy reveals that entrepreneurship has not been very influential in its development (Meller, 1998; Montero, 1997). Chile is not a country of entrepreneurs.[46] Innovation is scarce and entrepreneurs merely transfer innovations, technological or otherwise, from other parts of the world (Agosin, 1998). This is also generally done through traditional legal structures such as franchise agreements, joint ventures, distribution agreements and strategic alliances. Studies on economic growth in the country do not attribute any importance to the practice of law, other than in structuring and drafting the above contracts. Spikes and valleys in the growth rate are typically attributed to economists and government policies.

[46] This phenomenon is due in part, in my opinion, to the low level of education that prevents the country and Latin America in general from having highly skilled people for the invention of innovative projects. According to a recent report by the Inter-American Development Bank (IDB), Latin America needs one century to achieve development. According to that study, high school education and the quality of public institutions are the two critical areas that require significant reinforcement in order for Latin American countries to achieve competitiveness (wwwa.latercera.cl visited 10/14/2001). Mario Waissbluth has added, in the case of Chile, that: "What is curious is the schizophrenic discourse. Everyone agrees as to how serious the problem of education is ... when they try to understand the causes of our decreasing economic growth rate, no one seems to wonder what the hopes for international competitiveness are in a country where just 2.6% of the adult population is capable of elemental arithmetic reasoning ... There is a persistent, reiterative and incomprehensible refusal to acknowledge that the true engine of competitiveness of the country is hiding, at least partially, behind its bases of human resources and technological know-how. The issue of technology and education simply does not exist in the economic discourse ... It would be good to see some recognition of the fact that it is difficult to compete in the century of the Internet and globalization when less than 3% of the population is capable of simple arithmetic reasoning and less than 15% of professionals and technicians have that capability" (www.quepasa.cl. Las Telarañas del Crecimiento" visited 10/3/2001).

In the last decade, Chilean corporate law firms have experienced significant growth. The trend has been for these firms to grow gradually, in keeping with the Wall Street Lawyer Model. This is a deliberate imitation of the American system and explains in part why the firms that have grown, have done so due to a significant increase in their international clientele, particularly U.S. companies.[47] As a prestigious Chilean lawyer working in one of these firms has stated:

> "It is important to us that our American clients feel at home. They must not note the difference between their attorneys and us. We must dress and speak as they do. Our firm depends on its clients and the more comfortable they feel with us, the more time they will be with us and the more clients they will refer to us."[48]

However, in Chile, unlike in the United States, corporate firms seem to enjoy a better reputation among their clients.[49] Law firms are very careful to maintain their prestige. An ethical mistake can literally destroy a law firm in Chile. Additionally, the

[47] Chile has experienced significant growth in foreign investment in recent years. Relevant information can be obtained at www.foreigninvestment.cl.

[48] This is an abstract from a set of personal interviews conducted by the author with different Chilean attorneys who make up these firms. The questions were related to the way in which the law firms are being organized in Chile. My initial impression is that imitation is quite prevalent and in certain cases they are reaching the point where: (a) lawyers with divergent political opinions are hired to show that the firm is pluralistic; (b) women lawyers are hired, something that used to be unusual in Chile, since women are naturally absent for months when they are pregnant; (c) some more aggressive firms are even hiring lawyers who have openly declared their homosexuality; and (d) attorneys from different social origins are hired. At first sight, this imitation appears positive from a liberal perspective. Nonetheless, my perception is that they are merely strategic decisions rather than a true embracement. This is observed quite clearly when, according to the lawyers I interviewed, there are also tacit codes of conduct in most of these firms. These codes regulate matters as private as the color of the suit that is considered appropriate to wear in the firm, the length of your hair, the possibility of using a beard or moustache and other similar matters. As can be seen, even though this a merely a hypothesis, there is a certain cynicism in corporate lawyers' behavior. The firms outwardly present themselves as liberals but inwardly they are extremely conservative. Gossip is, in fact, frequent inside firms, according to the interviewees.

[49] Nonetheless, the prestige of the practice of law generally seems to be negatively perceived among the public although there are no recent and serious studies available. This situation is apparently more common among low-income people. In my opinion, and merely by way of hypothesis, one possible explanation may lie in the difficulties of the poor in achieving a timely and fair response to their problems from the judicial system. In summary, my theory is that the poor perception of a lawyer is linked to the problems of access to justice.

practice of law has had great influence on Chilean society.[50] Yet, there is no research on the true influence of lawyers on the growth of the Chilean economy. It remains a pending task. For this reason, when I refer below to corporate attorneys and to their role in the promotion of entrepreneurship, I will be speaking of what lawyers could be doing, and not of what they have already done.

The promotion of entrepreneurship requires a society that values entrepreneurial behavior. It requires a culture predisposed to entrepreneurship. This means, inter alia, preferring meritocracy over social origin or membership in a certain group or class. However, Chilean society seems to harbor contempt for meritocracy.[51] Personal contacts and family relations and/or power relations are usually essential when seeking a job or being promoted inside a company. Personal effort, experience, professional education and studies abroad, although they are taken into account, do not make a big difference. Thus, the spheres where money moves are commonly very narrow and the barriers to entry very high. This is an obstacle to entrepreneurship since there are no new ventures without financing. Gaining access to powerful economic groups in Chile for entrepreneurial initiatives, whether or not technological, is an enormous, if not impossible, task. It is a very closed circle that usually does business exclusively among its members or abroad.[52]

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[50] A significant number of presidents of the Republic have been attorneys while many ministers, diplomats, politicians, leaders and businessmen have also belonged to the legal profession in Chile. See [Urzua].

[51] I know of no serious studies on the matter but I make this assertion here by way of hypothesis based on my observations of Chilean society.

[52] Waissbluth has reproached the actual coalition government – The Coalition of Parties for Democracy – for their actions regarding the conservative economic elite: "By assuming the false equation of "entrepreneur = 19th-century right and opposition", the Coalition is losing one of the richest sources of world development in the 21st Century. If an entrepreneurial attitude and the creation of wealth do not form part of the ideology of this political group, if those concepts are surrendered without a struggle to the opposition, there can be little doubt that in the medium term, the Coalition has little chance of survival. The great challenge is precisely to find a third, fourth or fifth way in which entrepreneurship and the market are reconciled to the defense of

Consequently, social mobility from less privileged groups to wealthier groups is unusual (Fazio, 2000). On the one hand, the working class (i.e. the poor and low middle class) tends to be cautious and unambitious, with a significant aversion to risk, and they are content with just holding a stable job throughout most of their productive life. Their long-term aspiration is peaceful retirement in old age (if that is feasible in developing countries).[53] On the other hand, the upper class (meaning the upper middle class and the rich) to which most of the major entrepreneurs belong and, of course, their lawyers, is extraordinarily conservative with respect to values and attitudes,[54] it is classist[55] and it is centered on appearances.[56]

The major economic groups in Chile consolidated in fundamental ways during the military government of General Augusto Pinochet. Some did so legitimately, others through undue advantage, using privileged information as a result of their proximity to

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workers, with active attitudes regarding equity and pluralistic, tolerant and democratic values... and that is not achieved by handing over the values associated with entrepreneurship to the right" (www.quepasa.cl, "Las Telarañas del Crecimiento", visited 10/3/2001).

[53] In Chile, a new private social security system was implemented beginning in 1981. It is comprised of pension funds managed by Pension Fund Management Companies or AFPs, and they are based on what is called the individual savings account. Employers must mandatorily deposit a certain percentage of their workers' salaries in that account. The mission of AFPs is to obtain the highest return possible with the savings of their members so that those members can have a cumulative sum of money upon retirement that guarantees them a reasonable pension within the options provided by the system.

[54] It has basically been the Chilean conservative class (that generally coincides with the upper class, the political right and the rigid arm of the Catholic Church) that has opposed approval of a divorce law, has abolished the only type of abortion permitted in Chile (therapeutic), has opposed the elimination of a discriminatory matrimonial regimen such as the conjugal partnership, has fought to the end to prevent equality of rights among children and has systematically imposed censorship. This is to name just a few of the moral issues that have been of concern to the country after its return to democracy.

[55] This assertion is certainly very strong. I know of no studies supporting it. But I make it here by way of hypothesis. In my opinion, derogatory and occasionally arrogant language used by the monied groups to refer to the low-income population is a sign of classiism masked in Chilean society. The problems that occurred recently with the indigenous population seem to be another sign of the same.

[56] In my opinion, again by way of hypothesis, the privileged groups in Chile are heavily interested in having their members fulfill expectations of success that are assumed to belong to that group. Failure is not an option, since it normally means exclusion from the group.

power. For example, the privatization process that took place in Chile in the eighties was recently questioned in a polemic book (Monckeberg, 2001), and as far as I know, none of the serious assertions therein contained has been denied. During the transition to full democracy in Chile, new economic groups emerged whose fortune can, in certain cases, also be attributed to their access to power and to negotiations they have been able to influence (Brescia, 2001). Nonetheless, Chile currently enjoys a good international reputation with regards to transparency and is not seen as corrupt.[57]

My first hypothesis poses both the absence of an entrepreneurial culture and the concentration of wealth in only a handful of economic groups create a non-entrepreneurial economy in Chile. That approximately 80% of all jobs in Chile come from small and mid-sized businesses does not undermine this hypothesis if entrepreneurship is understood as a set of activities conducted by people who, through their creativity, offer either a lower cost product or service at the same level of quality as those already available on the market; or an equal-cost product or service of better quality than those already available; or a new product. Chilean small and mid-sized businesses generally lack innovative elements.[58]

If Chile does not have a culture disposed to entrepreneurship and if there are serious barriers to entry because of access to capital, the institutional infrastructure of the society constitutes yet another obstacle to entrepreneurship. Indeed, that infrastructure has serious flaws.[59] As said earlier, entrepreneurial initiatives usually imply a transfer of innovations

[57] See, for instance, www.transparency.org.
[58] And never technological innovation.
[59] According to the IDB, this is a problem affecting all of Latin America: "... there are three deficient areas in the region that affect the institutional framework: the rule of law, control of corruption and effectiveness of

from abroad to Chile or, in a variant of the phenomenon, Chilean entrepreneurs organize and launch their initiatives from the United States to later expand to other markets, including Chile. This situation considerably increases the cost and risks associated with a new venture. A brief overview of the Chilean capital market, the rules on corporate governance, the new labor reforms and some problems linked to tax laws will provide insight as to why this institutional framework hinders entrepreneurship.

The Chilean capital market has an insignificant number of transactions and its stability generates a variable impact on the condition of the country's economy, depending on the sector of the economy involved. As a consequence of globalization, the capital market is also dependent upon what happens in other markets in the world, and that makes it very sensitive and vulnerable to the comings and goings of the world economy. It is not a market that imposes guidelines of behavior but rather reacts to external behavior.

Additionally, despite serious efforts in the last two years to improve securities market legislation, it is clear that this does not suffice. It is not due to defects in legislative techniques or poorly designed public policies but rather to the political and economic culture of the country[60]. As a matter of fact, the legislation is relatively successful with large companies that make business deals involving significant sums of money, but is not so with mid-sized businesses, that transact on a smaller scale. As mid-sized businesses

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public administration." Enrique Iglesias, President of the IDB, has said in this regard: "Achieving a greater supply and a more productive use of financial resources, physical capital, human resources and technology is the backbone of the engine of growth. This great task must be lucrative and profitable both to companies as well as workers and to the society as a whole" (www.latercera.cl, visited 10/14/2001).

[60] However, the task is as yet incomplete. As the President of Chile, Ricardo Lagos, recognized in a recent interview, some macroeconomic reforms must end soon, "... such as the capital market reform. In particular regarding the changes to generate more venture capital. That is very important." (2001 Annual Report, *Revista Capital*: 33).

attempt to grow by requesting capital from the public, they find that there is no savings culture in Chile. Furthermore, there is no investment if people do not save. Worse yet, even among those who save, the stock exchange is a second investment option because it is perceived as a mechanism that is very difficult to understand with too many intermediaries.[61] Therefore, those companies will see a blocked road in the capital market. If the common man does not invest in shares on the stock exchange when companies go public, doing an IPO in Chile is not something that is attractive for a company.

For the same reasons, the way out for investors who require liquidity frequently involves mergers, acquisitions by transnational companies and other more specific alternatives such as direct and negotiated stock sales. And this is onerous to entrepreneurship. New innovative initiatives try to raise capital either traditionally (debt) or non-traditionally (capital), through different rounds of financing. Sooner or later investors will want to liquidate the investment and the most natural way out is through an IPO. This is simply infeasible in Chile, and for this reason, companies unable to implement an IPO on larger markets tend to slow their growth although not necessarily their profitability.[62]

In turn, the rules of corporate governance, or the rules regulating relations between shareholders, directors and the management of a company, were very precarious until a couple of years ago. In the recent past, this led to embarrassing international transactions,

[61] Finally, those who save and invest on the stock exchange will naturally try to invest abroad where the profit ratios are substantially higher.
[62] Another consequence of an IPO abroad is that the money tends to remain outside of the country, with the consequent impediment to growth of the national economy that this implies.

openly detrimental to minority shareholders in major companies that were subject to international public tender offers.[63] Those minority shareholders were, and are, fundamentally, the pension funds that invest the savings of all salaried workers in the country in variable and profitable projects. As a result, the absence of efficient, clear and transparent rules was an extraordinarily grave fact.

From the perspective of entrepreneurship, the rules of corporate governance are fundamental both to the founders of a new company as well as the investors, since issues of control and decision-making lie at the heart of the matters that these rules seek to resolve.

In addition to the problems associated with capital and the rules of corporate governance are the matters arising in the latest labor reforms.[64] The introduction of these reforms generated heated debate in the country.[65] Businesspeople blamed these reforms for a drop in the creation of new companies and the mass firings that were carried out immediately preceding the adoption of the reforms. Many commentators feel that the reforms make the labor relationship too rigid and that it has significantly increased the costs and the reserves of small and mid-sized businesses.

If that assessment is correct, it may seriously impact the heart of the Chilean economy since small and mid-sized businesses, as stated above, generate approximately

[63] One of the most controversial operations was the takeover by Endesa-Spain of Enersis in 1997, the so-called "Transaction of the Century".

[64] These reforms intend to make more rigid the labor relationship by complicating the way companies can dismiss employees as well as granting more rights to unions in collective bargaining. This is not something wrong by itself, but most of the problems are linked to the way the reforms have been designed and implemented.

[65] The Chilean press, before the reform was approved, reflects how emotions were present in this debate.

80% of the employment in the country.[66] In addition, rigid labor laws pose an obstacle to entrepreneurship. Being able to handle production costs, including the number of workers, flexibly in accordance with the requirements imposed by the newly developed company is consubstantial to the organization of a new business. If labor laws are very rigid, that assumption is not met.

Finally, tax law reforms must be briefly mentioned. There has been disagreement as to their purposes. Certain sectors feel that they camouflage the exemption of some transactions while at the same time, taxing others. This would produce a fictitious budgetary "equilibrium" and a significant flight of resources from the income of the population.[67] As reiterated earlier, this means that a significant portion of entrepreneurial initiatives occur abroad solely because of tax impacts, leaving the money outside of the national borders.

In summary, the perception that the existing institutional legal framework in Chile is defective results in the fact that entrepreneurship commonly starts abroad. The entrepreneur then comes to Chile, provided there is a market opportunity. But it is merely a

[66] Mario Waissbluth has recently opined the contrary: "If Chile grows at a rate of close to 4%, which is what it seems it would be doing, less than 40,000 stable jobs would be created annually. However, since our labor force of 5 million people grows vegetatively around 1.5 to 2% annually (or more, when considering the growing inclusion of women in the workplace), those looking for a job increase by 70 thousand to 100 thousand people per year. If this were so, the unemployment rate would not drop even a bit and we would need to grow at levels above 8% for 2 or 3 years just to maintain the actual levels of unemployment ... According to these data, we are at a specific moment when a 1% growth creates less than 0.1% growth in the employed population. This phenomenon has nothing to do with the fears of investment among entrepreneurs or the spurious phantom of the labor or tax law. This low creation of jobs occurred after the investment decisions were adopted" (www.quepasa.cl Las Telarañas del Crecimiento, visited 10/3/2001).

[67] I cannot justify this assertion for reasons of space, but the behavior of economic players regarding Chilean tax regulations seems at least to support this hypothesis. In fact, for example, tax lawyers must elaborate sophisticated corporate structures so that their clients pay less taxes without violating the law.

visit since, ultimately, he returns abroad again and capitalizes his earnings in the holding company he has there.[68]

Thus, if there is no entrepreneurial economy in Chile, and no entrepreneurial culture, if non-traditional capital is virtually inaccessible and if the institutional environment is deficient, it is difficult to imagine how lawyers may have fulfilled a role in promoting entrepreneurship—even under the Wall Street Lawyer Model--since there have been no concrete and economically profitable initiatives to promote.

II. Chilean Corporate Lawyers

There are few large law firms in Chile that provide integrated high-quality legal services in virtually all areas of the law, and they compete heavily amongst themselves.[69] Corporate law firms are generally small. The largest in the country -- Carey y Cía. – has close to 100 attorneys.[70] However, when one speaks of law firms in Chile, it is useful to distinguish between large law firms, mid-sized law firms and small law firms.

As said above, there are no large law firms in Chile comparable to those existing in the United States. However, the size of firms such as Carey y Cía and other smaller ones (but with more than 30 attorneys) are considered large firms in Chile and, as a result, they

[68] Exploring the ways in which this situation can be changed is a matter for future research in each of the areas mentioned.
[69] Information on the leading Chilean law firms can be found at www.latinlawyer.com
[70] See www.carey.cl

are influential because of their important clientele. These firms engage in providing legal advice to foreign or national companies in major transactions, meaning those that involve large sums of money. Consequently, these law firms could be called "corporate" as they concentrate on companies rather than individuals. Large law firms try to cover as many legal specialties as they can although they are rather reluctant to participate in litigation. The reason why these firms do not like to be involved in litigation seems to be a matter of reputation. In Chile, litigating supposes knowledge and acceptance of several informal practices that take place in the courts, some of which border on unethical. The judicial branch continues to a poor reputation among the general population despite sustained efforts in recent years to modernize the administration of justice. For the same reason, large law firms, save very exceptional cases, usually subcontract to firms specializing in litigation to defend their clients before the courts. Thus, large law firms do not take the chance of becoming enmeshed in situations that might damage their prestige. On the other hand, this does not apply to arbitration. As arbitrators enjoy a great reputation in Chile, large law firms are more willing to participate in that type of litigation since there is no risk of jeopardizing professional ethics.

Mid-sized law firms (meaning those that have less than 30 lawyers but more than 5) in turn render legal services to both companies and individuals. These firms also tend to render integrated service (covering all specialties, including litigation). Mid-sized law firms do not generally discriminate with respect to the clients they receive. Each client is seen as a new source of income.

Finally, we have small law firms. These firms of less than 5 lawyers, including lawyers who merely practice the profession, can be sub-classified into two categories. On one hand, there are firms that render general legal service in civil and commercial matters but also always do litigation. On the other hand, there are specialized firms. These are organized by areas of the law and are very professional. They are normally firms specializing in labor law, in litigation, in intellectual property, in family law, in tax matters and other similar areas.

Having made this distinction, it can be asserted, I believe, that all law firms in Chile are willing to provide legal services to companies and can be called "corporate" law firms. What differentiates them is the size, the specialty, the sophistication and the quality of the services offered. Certainly, the amount of the fees they charge and the type of clients they advise also sets them apart. Below, save specific mention, I will refer solely to large law firms and to emerging mid-sized firms.

Chilean corporate law firms are organized in diverse ways.[71] Some are simply "office mates". In this case, the lawyers are not partners to each other. They do business as a firm under a common name and lease or purchase an office together. They share common expenses proportionally and associate exclusively for specific transactions when the needs of any one of their clients requires diverse specialties or much work in a short period of time.

[71] For a comparative view, see Pérez-Perdomo, 1995.

Other firms are organized as limited liability companies and also employ salaried attorneys. In tax terms, this form of organization is generally more convenient but the partners must have the intent to treat each other as such, otherwise this association may be a source of trouble.

Finally, large law firms tend to imitate the hierarchical system of American law firms. They have partners, senior associates and junior associates. In these firms, the goal of the younger attorneys is to become a partner and the "tournament of lawyers" discussed in the first part of this work certainly takes place as well. As a result, the goal in large law firms is to replicate the Wall Street Lawyer Model. The most important criteria to becoming a partner are the ability to bring clients to the law firm, an exceptional reputation in some specialty and, at times, the social class to which the lawyer belongs or the political opinion he holds.

In the last five years, the tendency in large law firms has been to grow as fast as possible either by hiring more junior lawyers or through a merger with other law firms of similar size. However, these mergers have often caused problems in adjustment due to the need to harmonize different corporate cultures and working methods efficiently.[72]

Another trend in recent years that is typical of large law firms are strategic alliances with law firms in other Latin American countries and the United States aimed at providing

[72] Some law firms have had the option of merging with foreign firms but except for Cruzat, Ortúzar & Mackenna, who merged with Baker & Mckenzie, Chilean firms have been reluctant to make this type of merger since it would imply that many clients will leave the firm due to conflicts of interest and a good part of the independence of the local partners would be forfeited (because they would now be subordinated to the partners of the main office).

more integrated and global services. Some of these alliances are exclusive while others are not.

The fee structure of corporate law firms varies from firm to firm. Most firms charge only a fixed monthly retainer that covers all legal needs of the client. This sum is charged regardless of whether or not there was much, little or no legal work performed during the month that the fee is collected. Other law firms, the largest, use variable systems in addition to the retainer system mentioned above. They usually charge per hour of actual work for the client. Each lawyer in the firm has a price assigned to the hour of work according to the experience and specialty. There is a fee charged for every five minutes of work for a client in proportion to that hourly price. In order to avoid abuse in this system, firms tend to standardize certain jobs in terms of time. Additionally, there are lawyers in charge of carefully reviewing the bill that will be sent to the client to eliminate hours that do not add value. When firms advise clients on large projects, they usually charge a lump sum of money for the entire project. In certain cases, premiums are also stipulated for good performance according to criteria that are agreed upon previously with the client.[73]

However, the type of relationship between large law firms and their clients varies. Normally, if the client is a large company, firm lawyers do business with in-house company lawyers and occasionally with the CEO or CFO. The in-house lawyer acts as a mediator between the law firm and the company, and monitors both the legal work and the fees charged by the firm. Nonetheless, in Chile, it is not very common for companies to have

[73] Litigating attorneys usually charge a cash sum and a percentage of what is obtained in the lawsuit. The doubts that contingency fees have raised in the United States are not a subject of discussion in Chile.

in-house lawyers like in other Latin American countries such as Argentina or Brazil. The companies that do have in-house lawyers in Chile usually have one or two at the most performing the job.[74] Transnational companies, on the other hand, have their in-house legal departments abroad and from there they channel legal work to Chilean law firms.

When the client is a mid-sized or small company, the lawyer-client relationship is directly with the CEO or with other subordinate executives, depending on their specialty.

It can also be highlighted that the clients of large law firms usually belong to, and are treated as, clients of the firm and not as clients of one lawyer in particular. Nonetheless, on the rare occasion when a lawyer leaves the firm to work for another or to found his own, the clients he has assisted will usually move with him to the new firm. Perhaps the only time this does not occur is when the client has been advised for many years by the same law firm and that firm enjoys a stand-alone professional prestige that goes beyond the individual lawyer that works there.

The lawyer-client relationship is not, however, always fluid. Normally, the client believes that one must merely know how to read in order to understand the law. Consequently, it is not unusual for the lawyer to be interrogated by the client when the client has investigated the law on his own. It is also frequent for the client to have already acted on his own behalf without previously consulting the lawyer. In other words, the

[74] The exception to this rule is found perhaps in banks and insurance companies. Banks need to employ several lawyers to perform studies of property titles and established pledge or mortgage guaranties. However, it is not unusual for some banks to subcontract those services from an outside law firm. On the other hand, insurance companies need litigating attorneys but again, it is not unusual for them to subcontract that work.

client often seeks confirmation of what he believes to be legally correct rather than additional legal information. This means that lawyers must generally deal with getting their clients out of the trouble, rather than play a preventive role.

Consequently, the client may well see the lawyer as a transaction cost as well as a source of frustration and problems that prevent the company from moving forward at the speed of the rest of the business world. At the same time, lawyers are often incapable of truly understanding the client's business and, therefore, incapable of appropriately interpreting the true needs of the client. It is a sort of acquired incapacity as the roots are found in part in the system of legal education in Chile. This point will be discussed again below.

Nonetheless, what all large law firms in Chile have in common is that they only render legal services.[75] This assertion is not pejorative. In fact, this is all that is expected of attorneys and correlates to the way they have been trained. Lawyers must be capable of making available to the client the best solutions the legal system offers for the problem that has been posed. Agustín Squella and Francisco Cumplido have put forth a hypothesis that both lawyers, as well as their clients, expect the following services from an attorney: to defend the interests of the clients before the courts and/or the administration, to negotiate disputes or deals through direct contacts with the other party or with another lawyer, to advise on alternatives to legal action and the relative advantage of one over the other, and to make the arrangements necessary to complete a transaction. But, above all, these authors

[75] Of course, there are lawyers in firms with special business skills who advise the clients they serve in that regard, but this is unusual. Moreover, it must be pointed out that although attorneys do frequently form part of the board of directors of their clients' companies, the role they play is usually passive.

insist that, in Chile, lawyers and their clients think that lawyers should prioritize the interests of their clients over the interests of the legal system as a whole. (Squella, 1988; Cumplido, 1988) This perception – which has not been confirmed empirically – could explain some of the poor practices of Chilean attorneys, especially in the courts.

Legal service today is much more standardized than it was in the past, as result of computers and knowledge management software. Due to that standardization, lawyers add value to the transaction by reducing the margin of error in contracting. Lawyers also add value to complex transactions that require an appropriate handling of the set of laws and regulations in the Chilean legal system. Said otherwise, the lawyer knows how to handle information that is required to implement transactions securely, and also how to use that information in service of the client's interests.

In Chile, unlike in other Latin American countries, large law firms are not accustomed to lobbying. In fact, there is quite significant social reproach to lobbying activities in Chilean society. This does not mean that lawyers do not use some of their influence, within the limits of professional ethics, when they believe that the legal system will not award a fair solution to their client. Formal and informal conversations with regulatory entities are frequent, seeking to persuade them to act in a certain way. Lawyers also do not act as dealmakers, leaving that task to their clients. In this sense, law firms are rather passive. A possible explanation for this phenomenon could be the small market for the large law firms in the country and the strong competition among them. Normally the same top ten law firms are involved in the most significant deals achieved in Chile. And

these firms struggle for bringing clients in more than introducing their clients to other firms' clients. There is little cooperation among Chile's largest law firms.[76]

Finally, in the last two years large law firms also have experienced competition from large accounting firms. The big accounting firms have begun to establish strategic alliances with smaller but emerging law firms.[77] This has been quite controversial in the United States because of the potential conflicts of interest that the association implies; however it has not caused any such reaction among regulatory entities in Chile. Nonetheless, there is a fear in some law firms that this scenario signifies a reduction in their client flow. As a matter of fact, most foreign clients who decide to invest in Chile first contact an accounting firm and ask that firm to recommend a law firm. It is therefore clear that if the accounting firms have their own law firms, they will refer those potential clients to those law firms. As a result, the competition on the legal counsel market increases for leading law firms.[78]

III. Why Do Corporate Lawyers Not Foster Entrepreneurship?

It is commonly known that a law firm needs clients. Therefore, at the top of the list of priorities for founding lawyers is attracting the largest number of clients possible. In turn, clients must be sufficiently solvent to pay the fees of the law firm. This means that

[76] Observation made by the author.
[77] See, for example, www.servicioslegales.com
[78] In other countries, these matters, like others relating to conflicts of interest and professional ethics, are unusually regulated by the bar associations. This does not occur in Chile for the following reasons: (a) membership in the Chilean Bar Association is voluntary; (b) the Professional Code of Ethics has no force of law; and (c) the disciplinary authority of the Chilean Bar Association is very limited.

entrepreneurial initiatives are not, in principle, enticing to law firms because accepting entrepreneurs as clients signifies accepting the potential risk of non-payment of fees. Hence, law firms do not normally accept new ventures as clients. The exception to this rule is that large law firms can afford the luxury of risking profit to pursue new ventures that seem potentially interesting. This may perhaps be one way of producing a client. However, in truth, this situation is quite infrequent.

In addition to prudence, there also seem to be some cultural barriers that prevent lawyers from taking the issue of entrepreneurship seriously. Lawyers usually perceive themselves as mere intermediaries between the world of business and the law. The assumption is that entrepreneurs understand business and attorneys understand the law. Lawyers create the vessel into which the business will be poured. A Chilean lawyer does not perceive himself as a businessman but rather as a professional who facilitates a transaction. The client frequently visits his attorney with the commercial transaction closed, and merely asks the lawyer to draft the documents reflecting the parties' agreements.

In Chile, at the end of the 1960's, there was an attempt to change the perception of a lawyer as a simple intermediary (De la Maza, 2001). In that era, the leading law schools in the country agreed that there was a "law crisis" in the country (Merryman, 2000). In order to overcome the crisis, some authors who adhered to an ideological movement called "Law and Development" affirmed that lawyers must play a much more influential role in Chilean society and that the legal professionals, like none other, could be the starting point for the

articulation of economic and social development policies that were trying to be implemented through the government (Lowenstein, 1971). This point of view was a sort of "social entrepreneurship", as the movement aimed to create the necessary conditions to generate wealth trough the lawyers' work, but from the state (Urzua, 1971). As the members of this movement themselves would later acknowledge, that quite utopian idea was only modestly successful (Merryman, 2000).

Other than the ideological exception mentioned above, the current predominant perception is of the legal profession as a provider of efficient legal services (Squella, 1994). Far from being proactive, law firms are usually only reactive to their clients' requests for legal work. The client must also pay for these services, whereas the entrepreneur is in no condition do either. Chilean attorneys wonder how they can be asked to work with a company whose future success is highly uncertain and whose success determines whether or not the attorney's bill are paid. There does not seem to be sufficient incentive for lawyers to work with entrepreneurs. Lawyers do not see themselves in a profession that should be called upon to assume such a task. The origin of this attitude can perhaps be found in the way Chilean lawyers have been educated.

Chile embraces the *civil law tradition,* as opposed to the *common law tradition* adopted by most Anglo-Saxon countries. The civil law tradition (which dates distantly back to the work of Roman jurists and, more recently, to the rational-iusnaturalist codification) has fostered legal education adhering to principles of "legalism". Legalism is a certain

attitude towards the legal phenomenon consisting of identifying *the law* exclusively with *laws* (Squella, 1988). If the law is comprised of laws, then that is what must be studied.

In Chile, professors and textbooks normally adopt a legalist attitude. This signifies that professors limit themselves in class to explaining, more or less systematically, the content of the principal laws regulating their discipline. In turn, students must memorize those laws and be capable of reproducing them precisely in oral or written final examinations. Supporting texts merely repeat what laws provide, as well as offering some additional isolated jurisprudence (Squella, 1988).

Nonetheless, some professors adopt a more moderate attitude and teach legal doctrine in the way it is understood in German penal theory. In order words, they take the law to be a datum and from that point forward, they try to build at times highly sophisticated conceptual theories to resolve legal problems.

Finally, a minority of professors adopt a teaching methodology where students are more involved, and have the opportunity to employ reasoning on the basis that the law is just one of several elements that must be taken into account in the resolution of problems (Fuenzalida, 2001).

These three systems – formalist, dogmatic and casuistic – have strengths and weaknesses, but my theory is that all are insufficient for the training of a business attorney must be trained. And business attorneys are needed in order for lawyers to even conceive

of the possibility of promoting and encouraging entrepreneurship. Therefore, not only must the way in which the law is taught in Chile be changed ("formal or methodological change") but it must also be complemented by new contents ("substantive change").

Most corporate lawyers learn more from the business world by practicing the profession than they do in law schools.[79] This may be so, but law schools should facilitate that learning by developing in students certain faculties and skills sets that they can use in the future (Gilson, 1984). A basic knowledge of math, corporate finance, accounting, assessment of business plans, negotiations and transaction structuring should be in the curriculum of law schools—by no means mandatory, but there should be courses available according to the students' interests.

IV. Could Chilean Lawyers Foster Entrepreneurship?

My theory, as stated in the introduction, is that this is very difficult given the actual conditions. Cultural, institutional and strategic changes are required. This takes time even though the globalization of the economy can hasten things. For example, the failed boom of the dot-com companies and the pseudo-entrepreneurship that accompanied them in Chile are an example that people are willing to take the opportunities if they see them. This is, like everything, a matter of incentives and motivation.

[79] This assertion is valid in general but applies quite in particular to law firms where lawyers are usually hired right out of law school and are trained in the practice of the profession starting with very simple matters.

However, all the law firms who took risks in Chile, in fostering entrepreneurship where a significant part of the business model involved technology such as the Internet, failed, and lost a lot of money. The cause behind this failure must be investigated with respect to what attorneys really did, more than what the entrepreneurs did. Law firms tried to imitate venture law practice but with insufficient knowledge of what that practice truly involved. This explains why the practice has merely been duplicated with respect to fee structure, and that Chilean firms also exchange legal services for shares in the client' s company or subsidized chargeable hours. Chilean lawyers were unaware that there were several other essential components to venture law practice, as analyzed in the first part of this paper. Therefore, law firms committed the same error as the Chilean Internet entrepreneurs whom they—theoretically--advised: They bet on becoming rich quickly and effortlessly doing the same thing as always. Serious entrepreneurship does not work that way.

Chilean law firms made another mistake. They started to duplicate this pseudo-venture law practice mainly during the year 2000. Law firms did not realize that, at that time, the so-called "Internet Bubble" began to burst in the United States. However, this mistake is understandable, as even in the United States venture capital funds continued, inexplicably, invested in overvalued companies when the NASDAQ dropped, a phenomenon that is just being studied in that country (Bankman, Joseph, and Cole, Marcus, 2001). In short, Chilean law firms started badly and too late to practice venture law.

Creating interaction between lawyers, entrepreneurs, investors and research centers by aligning interests and encouraging cooperation would result in the first steps being taken towards a strengthening of entrepreneurship, even with a weak institutional structure. I believe that is the task and the challenge. It requires common interests in order to work fairly and transparently.

Can venture law practice be duplicated in Chile? The theory that I present is that it can actually be done. However, to do so, a sufficiently competitive market must be created where innovation is the rule. How that market will be created is something I explore below. For now, I will analyze what Chilean attorneys did during the Internet boom. This analysis is important because, as said above, Chilean lawyers acted intuitively, yet in a misguided fashion, in the belief that they were duplicating a model – venture law – that they did not fully understand. Important lessons can be learned here like from any failure. And that must, therefore, be the starting point.

The so-called Internet and dot-com company boom reached Chile late. The Chilean economy began to note the extraordinary economic growth occurring in the production of information technologies in early 1998. In fact, after years of maturing, some Internet companies and others that applied different technologies were beginning to undertake the most surprising IPOs on the NASDAQ.[80] Furthermore, some millionaire acquisitions of dot-com companies in Argentina – one of the Latin American countries where the boom had the greatest and best reception – opened the eyes of many ambitious people who

[80] This index reflects the values at which shares in high-tech companies are traded in the U.S.

mistakenly thought that becoming rich in one day without any effort was a realistic option.[81]

The newer ideology[82] postulated that the entrepreneur had to design and operate a website – normally an auction site or a financial advice site-- that had to be financed by some advertising "banners". In addition, the website had to have a significant number of daily hits. With that model in mind, the project was presented to potential investors, overvaluing, in a way that is now hard for us to believe, a company that did not yet have positive numbers in its balance sheet.[83]

At the same time, it became fashionable to believe that being a New Economy entrepreneur was the port of entry to a world that was usually off-limits to most people. The New Economy entrepreneur in Chile -- and in other countries of the continent – was (or should have been) a person with a strong personality, casual in manner, who did not abide by the established rules for doing business, and capable of talking to anyone who crossed his path as an equal. There was a certain vindictive arrogance in the environment among people who felt delayed – with or without reason – for years in their professional aspirations.

[81] The same happened in Silicon Valley (Perkins, Anthony B., and Perkins, Michael C., 1999).
[82] The ideology of the New Economy. A critical study of this ideology can be found in: Frank, Thomas, 2000.
[83] This New Economy mode was imported from the United States, where thousands of people made the same mistake as in Chile. The phenomenon has often been compared to the gold fever that struck California during the XIX Century. Many treasure seekers but few successful ones.

The New Economy entrepreneurs club was formed by implementing the so-called *the First Tuesday*, an idea imported from Europe, which consisted of meetings between entrepreneurs and investors that were held on the first Tuesday of each month. The businessmen and the entrepreneurs met each month in a certain location in Santiago, the former armed with new business plans, and the latter looking for potentially promising investments.[84] During the two years that this phenomenon lasted in Chile, business and society magazines always set aside at least one article on this new emerging class.[85]

Although the Internet and the digital economy were not a relaxed world – despite appearances --, the mistaken belief to make money one needed only a "strong personality" (to quote the headline on the first page of an important Chilean business magazine in reference the "Good Luck" of Patagon.com's case) [86] seemed to prevail. People were late to understand that in order to make money the New Economy entrepreneur had to work, and work hard.

Moreover, Chilean investors did not understand that doing business on the Internet did not differ substantially from doing business in the real world. A new venture needed a model, a development plan, capital and competent people.

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[84] See for general information www.firsttuesday.com. The Chilean site www.firsttuesdaychile.com does not exist any longer.

[85] Since this phenomenon occurred first in the United States, there was talk of a new social class, the "BoBos", for "bohemians – bourgeois". See Brooks, David, *Bobos in Paradise:The New Upper Class and How They Got There*, (New York: Simon & Schuster, 2001)

[86] The Santander Central Hispano bank paid by the 75% of the equity of Patagon.com almost 800 million dollars. This was something that seemed unbelievable in Latin America. For more information, see www.patagon.com

Perhaps the upside of this phenomenon was the implementation of a new type of labor relations. The corporate culture in Internet companies is a far cry from the traditional one and this is not by any means secondary in importance. The Internet culture supposes horizontally organized companies instead of vertically organized ones. The success of each member in the group depends on the success of the remaining team. This makes cooperative and trusting relations the rule and the foundation for success in Internet and other high-tech company. The community of interests that fosters entrepreneurship is not merely institutional but also a community that must arise among individuals inside a company.

The somewhat adolescent fashion described above also "contaminated" lawyers. Although most law firms viewed the Internet boom with a certain skepticism in the beginning, most ended up accepting the possibility that there was a next *Yahoo!* forthcoming among the group of Chilean entrepreneurs. The temptation made some firms take the chance and create a special dot-com department. Obviously, only the large law firms could afford that luxury since there was a heavy need for capital to open up a new line of legal assistance dedicated exclusively to that area inside the firm as well as a good intellectual property department.

Not more than 5 law firms undertook that challenge seriously and have competed heavily amongst themselves for a position on the market. These firms began to dress casually in imitation of their clients and attempted to implement venture law practice. The

word "attempted" is used intentionally. As explained above, Chilean lawyers limited themselves solely to replicating the fee system implemented by Silicon Valley law firms.[87]

Law firms were charging lower fees for their entrepreneurial clients or subsidizing them by postponing fee collection for several months in addition to requesting shares in the company. But they did nothing more. They did not act as dealmakers by presenting their clients to potential investors, nor did they advise them on the best way to conduct their business, nor did they monitor the performance of the new venture. What is more, because of generational problems, venture law departments were comprised of young attorneys whose experience in the business world was at best limited. Experienced lawyers felt alien to the phenomenon. The firms took on all entrepreneurs-clients requesting their services provided they already had a website on line. In summary, the lawyer–client relationship (within the glamour of the Chilean New Economy) turned out to be a sort of reciprocal marketing. Entrepreneurs bragged about having the most prestigious law firms in Chile as their legal counsel and the law firms in turn fought to appear in the press and in business magazines with the largest number of dot-com clients possible.

The romance should have lasted through April 2000, when NASDAQ came apart in the United States. However, it really finished in the year 2001.

[87] The resulting model was a sort of hybrid that inserted a shapeless Silicon Valley Lawyer Model inside the Wall Street Lawyer Model.

The losses of the law firms were considerable although the lawyers have been rather cautious in recognizing them. Entrepreneurs and their websites gradually disappeared or turned into more traditional businesses. They did not pay their legal fees and those lawyers who had acquired shares were left holding valueless paper. The failure was of great magnitude.[88]

Faced with this scenario, law firms had to react quickly. Most of the lawyers returned to advising traditional clients and the information technology departments became "e-commerce" departments, focused rather on "business to business" (B2B) initiatives. The boom had passed more like a hurricane that left merely destruction instead of a period of economic bonanza. Chile was late in arriving to the New Economy. It had not trained people nor had sufficient time to harvest.

Entrepreneurs, investors and attorneys learned the lesson: The New Economy is "new" only in that it adds more variables to the system of production, distribution and commercialization of goods and services. The basic rules of microeconomics continued to apply in this new scenario. In addition, markets are now more global than ever before and where there are none, like the case of Chile, they must be created. Can attorneys contribute to create a market for the innovation in information technologies? Should lawyers participate in such a task?

[88] In countries like Argentina, the failure was even more devastating. Law firms began to fire attorneys en masse. In one case, one of the most important law firms in that country fired nearly 50 attorneys at once.

By definition, a market requires supply and demand. The problem in Chile lies in supply. The absence of entrepreneurs and the lack of innovation are the core of the problem. There is an urgent need to implement changes, particularly in university education, and to create centers for entrepreneurial promotion. However, that task will take years. Hence, the question as to the possibility of creating a market is even narrower: can a market be created today?

If we need suppliers, namely entrepreneurs, we also need investors to finance them. As pointed out in the first part of this paper, the traditional sources of financing are not useful to this end. Therefore, a non-traditional industry must be developed in Chile, such as the venture capital industry.

Efforts are being made in this regard. Corporación de Fomento a la Producción ("CORFO") (Production Development Corporation) has designed an interesting program.[89] Matching funds is the basis of the program. CORFO will grant a credit facility at a low interest rate to companies that apply in the aspiration of becoming venture capital funds. The company selected receives the money from the credit facility. The challenge consists of those companies being able to raise a sum of money in a defined period of a time equal to the sum provided by CORFO, all of which will be used to form the fund.[90] If the company fails in that objective, CORFO retains the principal. If, on the other hand, the company is able to match the funds, then only the principal and the low interest should be reimbursed to CORFO from the return on the fund's investments. This is one way in which

[89] See www.corfo.cl for further information.
[90] So, for example, if Corfo provides 10 million dollars, the receiving company must raise another 10 million to form a 20-million-dollar venture capital fund.

the government facilitates the creation of wealth in the private sector, as most of the investments' profits will remain in that sector.

Having resolved – in theory – the issue of access to capital, still pending is the greater problem. There is no innovation without authentic entrepreneurs. If there are no entrepreneurs in the country, it is reasonable to seek them abroad by establishing appropriate incentives. There are public policies in Chile designed especially to do so. The transfer of innovative business and ventures to Chile is a clear objective of the actual government, although the task has not been either simple or successful thus far.[91]

The emphasis has been placed on high technology transfer. Two means have been established to do this.

On the one hand, foreign companies are offered venture capital financing in order to bring their technologies, research and development ("R&D") to the country. The process implies selecting or creating a Chilean company to act as a receiver of that technology. The foreign company is allocated a certain percentage ownership in the Chilean company, based on the appraisal of its technologies and R&D that will be contributed, and the remainder goes to the Chilean venture capital funds providing the money. This mechanism allows high-tech foreign companies to expand internationally even though their profits would normally not allow them to do so. Additionally, since the transfer process implies that the

[91] The main obstacle to technology transfer is the size of the Chilean market. A country with only 16 million inhabitants is not sufficiently attractive to many companies, howsoever stable its economy may be and relatively developed its rule of law.

necessary capital to finance the new venture will be contributed by venture capital funds in the country receiving the technology, the commercial risk to the foreign company is insignificant.

Furthermore, using more conventional means, strategic alliances have been sought between Chilean companies and foreign companies based on a technology distribution contracts.

The end goal of these policies is for new technologies to be exported from Chile to the rest of Latin America in a second stage, thus generating revenue for the country.

It is in this scenario where attorneys can, and -in my opinion- "should"[92] play a very important role, as shown by the case study that is analyzed below.

V. Case Study: LatinLawVentures Project

In a country where the venture capital industry is incipient and venture law practice has been misunderstood, the case of Latinvalley.com, Inc[93] is worthy of highlight. The merits of Latinvalley are not based so much on its relative success as on its extraordinary capacity to survive in a hostile environment, and on the vision of its founders to be at the vanguard of progress, but without haste.

[92] Lawyers should be interested in fostering transference of technology, because it is in their own interest to generate new clients. Therefore, there is a strong incentive.
[93] See www.latinvalley.com

Latinvalley was incorporated in the United States in February 2000.[94] Its initial business model aspired to make the company the leading incubator of Internet projects in Latin America. Latinvalley has only undergone one round of financing during which it raised sufficient seed capital to begin operations. All of its investors are individuals. Approximately 70% of Latinvalley's capital comes from United States and the remaining 30% from Latin America (mainly Brazil and Chile).[95]

The founders of Latinvalley saw and see in Latin America a set of opportunities linked to information technology. Latinvalley was founded by Cristian Shea, a Chilean, and by David Smolen, an American. Together they conceived the project and spent long hours at night working on it while holding down day-jobs as attorneys for Sullivan & Cromwell, one of the most important law firms in New York. Both Shea as well as Smolen have outstanding backgrounds.[96] Although Shea and Smolen are comfortable with the legal

[94] This is already indicative of how difficult it is to launch an ambitious business in Chile.

[95] This is an another sign that people are more willing to support innovations in the United States than in Latin America. In the case Latinvalley, Chile was the location where less capital was raised, basically because of the disbelief of the individuals whose contribution was requested, according to its founders.

[96] Between 1998 and February 200, Shea was an associate with the New York law firm of Sullivan & Cromwell. His practice mainly involved securities, mergers and acquisitions, and project finance work in the U.S., Latin America and Europe. In 1999 he also acted as counsel for Latin American legal issues and Managing Director in Chile for The Endeavor Initiative, Inc., a not-for-profit emerging markets venture catalyst. He graduated from Yale Law School in 1998 (LL.M.) and was later admitted to practice law in New York State. Previously he had worked as an attorney with Carey & Cia., Chile's largest law firm, acquiring extensive experience in the fields of corporate law, project and international trade finance, banking law, securities regulation, and environmental law. During his studies as a lawyer in Chile he worked with Banco de Boston (Santiago, Chile) in its banking litigation division and clerked at Mudge, Rose, Guthrie, Alexander and Ferdon, a New York law firm. Shea graduated from Universidad Diego Portales Law School and was admitted to practice law in Chile in 1994. Smolen, in turn, between 1997 and February 2000, was also an associate with the New York law firm of Sullivan & Cromwell practicing in the securities group with a primary focus on Latin America. Smolen has experience in mergers and acquisitions transactions in the financial services industry, the establishment of international investment funds, the regulation of broker dealers, and the structuring of complex derivative financial instruments. Previously, Smolen was a law clerk to the Honorable Richard F. Suhrheinrich on the U.S. Court of Appeals for the Sixth Circuit. He is a graduate of Stanford University in law (JD, 1996), political science (MA, 1996) and international relations (BA, 1988)

profession, they do not foresee spending their entire life dedicated to disproportionate work days followed by a partnership someday in the firm, working at the same intensity at a highly stressful and standardized job. The vision and dream of both was to launch their own company.

As soon as Latinvalley began operation as an Internet project incubator, its founders took an unusual step in people with entrepreneurial personalities who also have knowledge of the business world: They hired a sufficiently experienced manager to be CEO of the company, who would guide them on how to plan and develop the new venture.[97] This decision has proven, after two years, to be the right one. In fact, Latinvalley not only lasted beyond the end of the Internet boom – in the way we will see below – but was also capable of building an outstanding international network. This is proven, for example, by the composition of its Board of Directors,[98] which is extraordinarily exceptional given the

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and was the Book Review Editor of the Stanford Law Review. Prior to graduate school, Smolen spent nearly four years in the Dominican Republic, where he was a Peace Corps Volunteer working as a community organizer on a sugar cane plantation and a trainer of Peace Corps Volunteers in Santo Domingo. Smolen is a member of the New York Bar Association and is the current Chair of the Stanford Law Society of the Greater New York Area. See www.latinvalley.com

[97] David Hamilton was the one chosen. Between 1987 and 1999, Hamilton was the Chairman, President and CEO of Chemical Leaman, Inc., the Nation's largest tank truck company. Previous to that, between 1975 and 1986 he acted as President of Szabo Food Service Co., a contract food service company managing facilities for corporations, hospitals, schools and sports arenas. Previously he served as a Vice President at Allen & Company (1971-1975) and worked as an Assistant Treasurer with Morgan Guaranty Trust Company (1966 - 1970). Hamilton holds an MBA (1966) from Harvard Business School and a BA (1961) from Rice University. During his tenure at Szabo and at Chemical Leaman, Hamilton led the expansion in revenues from $59 million to more than $220 million and from approximately $200 million to $380 million, respectively. In both companies he managed an extensive network of offices spread out over a wide geographical area. Furthermore, he undertook a major technology initiative at Chemical Leaman starting in 1995 that involved him in many Internet issues at the beginning of the Internet age. Finally, to accelerate growth in both companies, he initiated seven new businesses, four of which were complete start-ups. All seven reached profitability and commercial success. See www.latinvalley.com

[98] I will mention here only the international board of directors of LATINVALLEY. Local board of directors can be seen at www.Latinvalley.com: ***Henry Breck.*** Chairman of the Board of ***Ark Asset Management Co., Inc.*** (a private institutional asset fund manager – New York). He was formally a partner in ***Lehman Brothers, Inc.*** where he was Chairman of the Board of ***Lehman Asset Management Co., Inc.*** Henry is a graduate of ***Harvard College*** (1958) and has a Masters from ***Oxford University*** (1960). ***Eugenia Wilds. Managing***

background of its members. Further proof of this is the international conference co-organized by Latinvalley, Stanford Law School, Diego Portales University School of Law and Carey y Cía. in October 2000, which brought together prominent attorneys and economists from Chile, Latin America and the United States in Santiago, Chile.

Furthermore, Latinvalley has been able to recruit highly skilled people in opening up its different offices in Latin America and developing its different initiatives. Shea and Smolen were always clear in that quality prevailed over quantity. For the same reason, only one or two people were needed to open up an office while the luxury and decor of those offices was somewhat secondary. We will see below that this was key to the survival

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Director and Executive of ***Latin American Loan Syndication Division*** of ***Dresdner Bank-Dresdner, Kleinwort, Wasserstein*** (New York). Eugenia was previously ***Senior*** Vice President of ***Latin American Loan Syndication Division*** de ***J.P. Morgan & Co., Inc.*** (New York). ***Felipe Larraín Bascuñán, Professor of the Institute of Economics of the Catholic University of Chile and Associate Professosr at Harvard University.*** He was ***Visiting Professor*** of the ***Robert F. Kennedy School*** of Latin American Studies at Harvard from 1997 to 1999, where he led the project "Central American in the XXI Century". He is also the President of Felipe Larraín & Asociados. Since 1985, he has been economic advisor to the governments of Bolivia, Canada, Ecuador, Jamaica, Mexico, Nicaragua, Paraguay and Peru as well as to the United Nations, the World Bank, the Economic Commission for Latin American and the Caribbean (ECLAC), the ***Interamerican Development Bank*** (IDB) and the International Monetary Fund. He is currently advising the governments of Bolivia, Colombia, Costa Rica, El Salvador, Guatemala, Honduras and Peru. He has also been advisor to and member of several board of directors in Chile, Latin America, the United States and Europe. He has written and published a total of 8 books, the most prominent of which is "Macroeconomics in the Global Economy" (1993), which he wrote in conjunction in professor Jeffrey Sachs of ***Harvard University***. Felipe holds a masters and ***Ph.D.*** in Economics from ***Harvard University*** and a degree of Business Engineer from the Catholic University of Chile. ***David Gant, Vice President of Global Service Providers*** of ***Lucent Technologies' AVAYA Communicatio***n. He has global responsibility of all Internet access services, including ***PTTs, ISPs*** and ***ASPs.*** He used to be Regional President for ***Enterprise Networks*** of ***Lucent Technologies*** in the Caribbean and Latin America. There he was responsible for implementing Lucent international strategies and developing entrepreneurial business in the region to become the market leader in areas such as business communication systems, call centers, message systems and wireless systems for businesses. He was also Regional Director and Chief Executive Officer of ***Cisco Systems, Inc.*** for Latin America and the Caribbean. He has more than 20 years of experience in marketing and sales, business development, negotiation and distribution strategies in Latin America and the Caribbean. He was also director of marketing and sales for for ***Wang Laboratories, Inc., NEC Information Systems,*** and ***AT&T Information Systems. Eric Estes, Senior Director of Campbell Lutyens*** & ***Co. Ltd.*** **(**www.campbell-lutyens.com**)**, in the private investment fund placement division. He has more than 10 years of experience in the US Private Equity Market. Eric worked for more than 2 years previously with ***WR Hambrecht + Co*** (New York), where he created and managed its private investment fund placement division and advisory activities. He also worked in the area of private equity finance for ***ING Barings*** (Londron), ***Zephyr Management*** (New York) and Hambrecht & Quist – Asia Pacific (San Francisco) and the ***Overseas Private Investment Corporation*** **(*OPIC*)** (Washington, D.C.). See www.latinvalley.com

of Latinvalley after the fall of NASDAQ less than 4 months after Latinvalley began operation.

Latinvalley opened up its first office in New York. A foot in the financial center of the world was essential. Latinvalley then inaugurated offices in Chile and in Mexico. Brazil was the third office in Latin America to be launched in mid-2000. The team worked under the vision that there was no hurry to inaugurate an office in Argentina even though the Internet boom in that country had developed more quickly than in other parts of the region. Time would prove they were right in this regard, given the recent political and economic events occurred in Argentina. The Latinvalley team has never numbered more than 12 in the handling of all of its ventures.

However, Latinvalley was not the only company in the incubator market in Latin America. In Chile alone the competition was fierce.[99] The founders therefore had to develop, and did in fact cultivate, several competitive advantages. First of all, they built a regionally connected platform through their diverse offices and, above all, through the important network of contacts of the task force. Secondly, the vision, experience and intelligence of its CEO, as stated above, were essential to facing points of strategic inflection. Third, the task force, although small in comparison to the competition, was and is high in human and professional quality. Fourth, the skill in making the initial investments in companies that proved to be successful was also determining.[100] Fifth and

[99] The main competitors of Latinvalley were ideasupply.com and eventures.com. None of these companies are now in the market as competitors.

[100] ***Bazuca.com, Inc.,*** www.bazuca.com; ***Axcesso S.A.***, www.Axcesso.cl; and LatinAmericanLawyer.com, Inc

last, the practice of halting investments that did not seem to be on the right path – thus internalizing the loss quickly – was an essential factor.

Nevertheless, perhaps the most important feature of all was the flexibility in radically changing the company's business model when required by the contingency.

Indeed, after April 2000, when NASDAQ fell in the United States, investors in the technology market panicked. There was an abrupt halt to investments in dot-com companies. Nonetheless, in Latin America, people continued to think that disproportionate sums of money could still be earned on the basis of a good idea without significant effort. Latinvalley nonetheless realized from the beginning that reality was otherwise and that extremely difficult times were to come. Consequently, a change in the business model was imperative. Latinvalley therefore stopped being an incubator of Internet companies and became a company that fits in an intermediate category of what a venture capital fund and incubator would be. It is what its founders called a "venture development company".[101]

On its part, the competition--specially in Chile--continued to do business as if nothing had happened on the markets. After a few months, they were facing serious cash flow and finance problems. This occurred for two basic reasons: First, those companies had used a good part of their capital to buy or lease luxurious offices. And second, they hired too many employees. For example, in Chile, Latinvalley started with a team of no more than four people while the closest and most important competitor employed 60. The

[101] The actual business model of Latinvalley is now divided into three areas: (a) venture capital; (b) investment banking; and (c) venture law.

competition went broke and simply faded away and they are no longer spoken of. Latinvalley thus became the sole survivor. This gave it prestige and guaranteed a recognized reputation in matters linked to entrepreneurship.

For this reason, in December 2000, Latinvalley was chosen by MiFactory[102] – one of the first venture capital funds set up in Chile – to be the manager of that fund. MiFactory is comprised of serious transnational investors such as Ericsson, Saab and the Said Group from Chile. Its investments focus on wireless technology in Latin America. The regional platform of Latinvalley has proven to be extremely attractive to this fund.

One of the initial Latinvalley ventures was to develop the practice of venture law. However, the strong conservative culture in Chilean law firms analyzed earlier was a severe obstacle. Initially, Latinvalley planned to have one of the large law firms associated with the company, and jointly create a satellite office dedicated solely to start-ups, duplicating the model that VLG developed in Silicon Valley. However, no firm bought the proposal because they considered it too risky. What law firms did do, as explained above, was to implement a pseudo-venture law practice themselves that was a total failure. Latinvalley, on its part, decided to bide its time.

Latinvalley has now changed its strategy. It plans to begin a different venture law practice where the business model and characteristics are adapted to the Latin American

[102] See www.mifactory.com

reality, which we describe below. This is what has been called the LatinLawVentures Project within Latinvalley.

It is clear that in Chile and in other countries in the region, there are insufficient entrepreneurs capable of creating technology innovations in the way that it is done in the United States, Europe and Asia. Accordingly, the target market of venture law practice is small and short-range. This is a clear limitation that is hard to obviate. However, Latinvalley feels that a target market can be created through transference of technology to Latin America. One of the possible tools in initiating this transference of technology are credit facilities and subsidies that CORFO has available. Latinvalley and CORFO have begun negotiations to create the Latinvalley Transference Venture Capital Fund. This fund would be created through a matching fund system. As explained earlier, this implies that Latinvalley would make fundraising work under the commitment of CORFO to match every dollar raised by Latinvalley. For example, if Latinvalley raises five million dollars, CORFO must put out another five million dollars to form a fund of ten million. This process is by no means new in Chile, as discussed earlier. Indeed, part of the money from MiFactory was obtained in this way.

Once Latinvalley Transference Venture Capital Fund is created, the targets are small and mid-sized businesses in the United States, Europe and Asia, meaning those companies that invoice at least five million dollars annually and face significant restrictions in expanding quickly in their respective countries. Latinvalley Transference Venture Capital Fund would offer those companies the opportunity to set up shop in Chile and

develop their different products and services from there. Latinvalley Transference Venture Capital Fund would invest in these companies in Chile, whether they set up shop alone, through a subsidiary or through a joint venture with a Chilean company. In the medium term, the process to expand the transference of technology from Chile would be gradually exported to the rest of Latin America. In addition, Latinvalley, either itself and/or through MiFactory, would also transfer technology or make direct investments in companies that they regard as potentially attractive.

In this way, Latinvalley would overcome the first problem in the Chilean economy and in Latin America in general: the absence of a target market with genuine technological entrepreneurship.

Once the target market has been created, the next step is to develop venture law practice correctly. Hence, the Latinvalley business plan includes the launching of a high-level law firm – through the creation of a subsidiary – LatinLawVentures – engaged exclusively in providing legal and business assistance to startups arising from the technology transference process, together with those that are created through the investment of Latinvalley and MiFactory, as indicated above.

The LatinLawVentures project was launched at the end of 2000. The project assumed recruiting several attorneys with international experience who were willing to run the risks of a venture of this type. The firm, which will begin to do business in Chile in June 2002 and will then open up two more offices in the first half of 2003, one in Brazil

and another in Mexico, will thus become a regional law firm. LatinLawVentures has two options for its development, depending on the market size. First of all, it could associate with a mid-sized law firm in each country and request research and development from that firm, i.e. form contracts and knowledge management systems required to operate with zero margin of error in rendering standardized services, in exchange for LatinLawVentures referring clients to them once they have passed the start-up stage and have achieved a relevant level of corporate growth. Second, it could confront the business in each country with a significant initial investment and thus acquire directly the set of form contracts and other necessary documents according to the legislation of each country in order to launch new companies. Which of these two options it will take is something that is now being negotiated.

The LatinLawVentures project assumes that the fee structure will be comprised of money to cover the operating expenses of the firm and the option of buying shares of the new company.

Implementing this practice in Chile and then in other countries of Latin America is easier in certain aspects than it is in the United States, but it is more difficult in other ways. As a matter of fact, the potential conflict of interest between lawyer and client or between lawyer and investor is not something that is regulated in Chile. Although some questions of ethics can arise in certain cases, it is not a legal matter. Furthermore, referring clients to other law firms and charging for that referral is something that can be done in Chile without

violating any ethical or legal rule. Therefore, in this regard, the model is merely a matter of implementation.

However, what is more complex is the issue of divestment. As we have seen, Latin America does not have an efficient capital market and there is no popular investment savings culture. For that reason, if LatinLawVentures will take on an interest in the capital of its clients – because it is there where the potential earnings lie that offset the risk -- it will face the problem of how to liquidate its investments. Obviously, the simple way out is for the client to be purchased by a larger company, in whose case the shares are simply sold to that company. The complicated way out until Chile and the rest of the region have an influential capital market is to undertake an IPO in the United States. This certainly benefits the business of LatinLawVentures, but, as I pointed out earlier, it does not benefit the country or the region since the large share of earnings will remain in the United States.

This is a structural problem that goes beyond the analysis of LatinLawVentures as a case study but clearly demonstrates how tremendously innovative and creative ventures that could create wealth for the country are significantly limited by institutional weaknesses. In any case, what is clear and what is of interest to point out here, is that in this way, lawyers can promote entrepreneurship in Chile and from there to the rest of Latin America. That is extraordinarily valuable in and of itself.

Thus, still remaining is the question of whether lawyers should or should not be concerned with promoting entrepreneurship, either through venture law practice or in other

ways. The truth is that this is a simple question to answer. Leaving aside the considerations that the promotion of entrepreneurship has for the economy of a country in and of itself, it is clear that law firms should be significantly motivated to develop new ventures with a genuine potential for success. Why? Merely because law firms need clients – that is their business. Therefore, promoting entrepreneurship is – as shown by the experience of the United States– the best way to generate a source of clients. Can there be anything more attractive than creating the client itself? This requires no further comment.

CONCLUSIONS

In the United States lawyers have fostered entrepreneurial initiatives from at least a century ago. The intensity of this task, however, has varied over the years. Under the Wall Street Lawyer Model, law firms gradually became bigger as their clients did. And in so doing, law firms developed an especial relationship with their clients based on trust as well as mutual personal support. When law firms became large enough, a more formal relationship replaced it. At this point, clients "belonged to" the law firm rather than to a particular attorney. Also, lawyers started to render standardized legal services and they were less often fully involved in their clients' business strategies and new ventures. This fashion of practicing the legal profession led to a bad perception of corporate lawyers, since clients perceived them as transaction costs, deal-killers and, sometimes, greedy and amoral operators of the legal system.

During the last decade some law firms from Silicon Valley challenged the way the Wall Street Lawyer Model had been working. This law firms took advantage of the economic growth generated by the production of high technologies and the Internet boom in the region. The Silicon Valley Lawyer Model proved to be extremely successful in creating a legal practice called *venture law*. According to this practice, law firms invested in selected high-tech new ventures, either directly or by asking clients' shares in exchange of legal services (instead of charging normal fees to their clients). In so doing, lawyers became the bridge within a venture community composed of entrepreneurs and investors. Lawyers functioned as dealmakers, business counselors, gatekeepers, matchmakers and

proselytizers, and they were as successful as their clients until the drop of the NASDAQ in April of the year 2000. After this month, the Silicon Valley Lawyer Model has been experienced changes in order to adjust its needs to the new economic reality.

In Chile, in turn, a few large law firms attempted to achieve a legal practice such as venture law between the years 1999 and 2001. This endeavor was a failure. These law firms tried to duplicate the Silicon Valley Model Lawyer without knowing exactly how such a model really worked and without having the necessary skills to implement it. The legal institutional framework of the country, the legal education, and cultural traits were also factors that contributed to this failure. Nevertheless, the lack of a market for innovation in high technologies was certainly one of the most significant problems that Chilean lawyers did not take into account in duplicating venture law practice. On one hand, Chile did not have good entrepreneurs in the field, and, on the other hand, the venture capital industry was in the beginnings. In such scenario, realistically, lawyers did not have much to do.

In spite of the failure, lawyers could certainly foster entrepreneurship in Chile. The main challenge is to create a suitable market. Lawyers should be interested in creating the institutional conditions for a new market of high technologies, as it might be a good source of clients and profits in the long run. One way for achieving this goal is to actively promote transference of technology from the rest of the world to Chile. The Chilean government has been doing an endeavor to accomplish this goal. By generating a matching system to foster the venture capital industry, and by implementing ways to enhance small companies that

potentially could be able to act as a recipient of foreign technology, the government is building a reasonable efficient institutional framework favorable to the entrepreneurship.

The next step will be more difficult. It implies that the players, that is to say, entrepreneurs, investors, lawyers, and educational and research centers must be able to create a community of interests based on mutual trust and cooperation. How long will this process take, if possible? It is hard to predict.

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