BEETLES, FROGS, AND LAWYERS: THE SCIENTIFIC DEMARCATION PROBLEM IN THE GILSON THEORY OF VALUE CREATION

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In 1984, Ronald Gilson published what, by almost all accounts, has become a classic in the academic literature of the legal profession: a theory explaining how it is that lawyers add value to business transactions.[1] Though it will take a scholar of my great-grandchildren's generation to determine whether it was a classic in terms of explanatory power or simply a cultural artifact, I will venture out on a limb now, almost a quarter-century after its publication. I suggest that its assumptions, methodologies, and conclusion are those of a particular place and time, during which what Jürgen Habermas called the "empirical-analytical" approach to human interaction[2] reached its peak. In the eighteenth and nineteenth centuries, more and more of what used to merely fall within the broad reach of philosophy peeled away to become science. In the physical sciences, natural philosophy transformed into the separate disciplines of physics, chemistry, biology and so on. Under this "nomological" approach, the job of science was to observe regularities and to subsume them under hypotheses, theories, and laws capable of predicting—based solely on previous observation and logic—what would occur if the same conditions presented themselves in the future.

In the late nineteenth century, there developed for the first time something known as "social science," in which this same "empirical-analytical" approach came to dominate the methodical study of

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1. Ronald J. Gilson, *Value Creation by Business Lawyers: Legal Skills and Asset Pricing*, 94 YALE L.J. 239 (1984).

2. JÜRGEN HABERMAS, ON THE LOGIC OF THE SOCIAL SCIENCES (Shierry Weber Nicholsen & Jerry A. Stark trans., 1988) (1967).

human affairs.[3] In the late twentieth century, it came to dominate the study of law as a human institution. In the meantime, however, philosophers of science (usually not the scientists themselves) spilled gallons of ink trying to demarcate between true science—which takes on a privileged epistemic status—and pseudo-science, like phrenology or astrology, disciplines we want to argue are not so privileged. To put it otherwise, we would all agree that Einstein's theory of general relativity or Newton's theory of gravity are science, even if they are ultimately shown not wholly to explain natural phenomenon. On the other hand, very few of us accord the same level of epistemic respect to the Biblical account of creation in the first chapter of Genesis. While Genesis may provide "truths," these truths are not of the scientific kind. Somewhere in between the two extremes are the close cases over which philosophers of science argue, and that is the "demarcation problem."

My argument is not that Gilson's theory of value creation—which, as discussed below, rests on the presupposition that the involvement of lawyers in a transaction can only be explained if they add to the total economic surplus—fails as a matter of explanation. It is that the explanation is not entitled to privileged epistemic status, *i.e.*, worthy of being given respect as an approach to truth in a scientific way, particularly as compared to cultural or hermeneutical explanations of the role of the lawyer in the transaction process.[4] To put this a different way, Professor Gilson said this at a recent conference of a transactional practitioner turned legal academic: "'He was a beetle before he was an entomologist.'"[5] The implication is that the entomologist's view of the beetle's place in the world has a

3. THOMAS L. HASKELL, THE EMERGENCE OF PROFESSIONAL SOCIAL SCIENCE: THE AMERICAN SOCIAL SCIENCE ASSOCIATION AND THE NINETEENTH-CENTURY CRISIS OF AUTHORITY 3 (2000); *see* HABERMAS, *supra* note 2, at 2–3.

4. *See* George W. Dent, Jr., *Business Lawyers as Enterprise Architects*, 64 BUS. LAW. 279 (2009). Professor Dent provides a recent and thorough critique of the Gilson thesis, the thrust of which is that the Gilson article is flawed or incomplete because it bases its generalizations about value creation on a narrow segment (mergers and acquisitions work) of what lawyers actually do. Most of Professor Dent's criticisms are well-taken, but he is as willing as Gilson—based merely on common sense—to accept that economics drive clients' decisions to hire lawyers. *Id.* at 286. Professor Dent, however, does not deconstruct the basis of the economic model by which Gilson concludes that lawyers have to be involved because they increase the value of the transaction for the clients jointly and not separately.

5. Posting of D. Gordon Smith to The Conglomerate, http://www.theconglomerate.org/2008/11/he-was-a-beetle.html (Nov. 15, 2008).

privileged epistemic status over the beetle's perspective.[6] I disagree, or at least I think the matter needs to be more fully explored.[7]

We can begin by positing an example of an economic hypothesis that seems both unremarkable and testable. Microeconomic theory predicts that firms will stop production of a good when the marginal cost of production exceeds the marginal revenue. There, it seems to me, the allusion to beetles and frogs as the objects of study make sense. We really do not care what is going on in their minds; rational beetles, frogs or clients should not be making widgets when the costs of the very last widget is more than the firm will receive in revenue. We can study hundreds of firms and see if the theory holds: if firms are producing and selling widgets at a loss on the marginal output, something needs to be done about the theory.

Professor Gilson's explanation of value creation is problematic in a way that the foregoing theory is not. Indeed, my claim is that explanation is at the very edge, if not over the edge, of what may be called science. Here we need to unpack the economic view of value. All transactions occur because buyers value an asset more than sellers. The difference between the two values is surplus. Haggling over the split of the surplus is of no interest generally to economists; that is mere strategic bargaining. Each party, being rational, would know that hiring a lawyer to grab a bigger portion of the surplus won't work because the other side will respond in kind, and the lawyers, not the parties, would get the benefit of the surplus. So, in the long run—rational actors being what they are—it must be the case that "'[t]he increase must be in the overall value of the transaction, not merely in the distributive share of one of the parties. That is, a

6. Professor Gilson has confirmed to me via e-mail that this is accurate. He also made clear something that was already obvious to me from the 1984 article: he was looking for a systematic way of explaining what he had done as lawyer. I am sympathetic to Professor Gilson's overall project in that I am also a beetle turned entomologist. I prefer, however, to think of what I do as "making sense" of my life as a beetle. Therein lies a subtle difference. Neither before hearing him nor since then have I thought he was attributing privileged status to lawyer-entomologists over lawyer-beetles. Nevertheless, the reason the quip is clever is because it suggests that the objective study of the beetle using the tools of social science is privileged in a way that inquiry into the beetle's (or the beetle's clients') subjective attribution of meaning to the activity is not.

7. This is not the first non-mammalian metaphor used by an economically inclined legal academic to demarcate those who study and those who are studied. As Richard Posner so colorfully described rational actors as they appear to economists who study them objectively: "[I]t would not be a solecism to speak of a rational frog." RICHARD A. POSNER, ECONOMIC ANALYSIS OF LAW 17 (6th ed. 2003).

business lawyer must show the potential to enlarge the entire pie, not just to increase the size of one piece at the expense of another.'"[8]

This is a key move (and one worthy of a good lawyer) because how Gilson frames the issue largely dictates the outcome. He identifies three perspectives on the question of value: those of clients, some of whom would suggest that lawyers reduce the value of transactions; those of business lawyers themselves, who would view their value-enhancing status favorably; and the "neutral but still positive view offered in the academic literature."[9] That is to say, everybody seems to agree that there is a relationship between the lawyer's involvement and the value of the transaction; rational actors hiring lawyers would not allow that involvement to reduce transaction value. Thus, the only remaining question is the uncovering of the regularities under which we can expect that lawyer involvement does indeed create value. Note how far we have already come. In the philosophy of the natural sciences, causation is a hotly debated issue. When we observe regularity in nature, theory now supplies an explanation regarding why there is regularity. But here we have simply assumed, on anecdotal evidence or the exercise of reason (not logic), that there is such a relationship.

What if there is no relationship? My theory is that lawyers sometimes add economic value to transactions and sometimes subtract economic value, but lawyers also appear during the deal for the same reason Hermes scarves or Neiman Marcus neckties appear in business attire: it's part of the ritual. There is no intrinsic reason they have to be there. Lawyers—like scarves or neckties—may well have economic value, not because they necessarily make the pie bigger any more than scarves or neckties do so, but because somebody values the lawyer enough to pay more for her to be there than it costs the lawyer to be there (marginally speaking, of course). That's the reason we buy expensive scarves and neckties and Raymond Weil watches as well. But we don't feel a need to justify the presence of the scarf or necktie in connection with the value of the transaction other than to buy the product. In other words, why not assume lawyers are there because they bring value to their clients that exceeds the cost of their being involved in the transaction, rather than assuming that they are there because they actually increase the overall surplus the transaction creates for *both* parties?

8. Gilson, *supra* note 1, at 246.

9. *Id.* at 241–43.

It is the word "value" that is value-laden. What if lawyers' involvement in business transactions is not explained at all by the increase in transactional surplus, or even that lawyers cause clients to get a larger share of a fixed surplus, but because the work of lawyers in deals has cultural or hermeneutic significance? That is, we look not necessarily for economic value in the lawyer-client relationship but *meaning*. I am persuaded by years of observation of great lawyers that their involvement may not add value, but it is meaningful. However, the linkage of that involvement to what lawyers do *qua* lawyers (*e.g.*, argue for hours over the wording of myriad representations and warranties) is attenuated. Some have suggested that the real role of a lawyer is akin to deal manager or quarterback. That strikes me as an aspect of leadership, something that business schools teach but something with which law schools and law practice (qua what lawyers actually *do* in the transaction) struggle immensely.

Consider the analogy to the role of a rabbi in a Jewish wedding. A Jewish marriage is not a sacrament. It is a contractual relationship, evidenced by an agreement called the *ketubah.* The ketubah is a standard form drafted by rabbis, who in this regard can be considered practitioners of Jewish civil law. In traditional practice, it is signed at the betrothal or engagement, not at the actual marriage ceremony, and is considered more important than the ceremony. Nevertheless, the rabbi officiates at a ceremony, even though the marriage itself consists of commitments the bride and groom make to each other without the rabbi.[10] Rabbis get paid for doing this. Should we assume that rational spouses-to-be would only pay the rabbi if the rabbi added value to the transaction (say, for example, by pre-marital counseling), given that the rabbi is not a legally mandatory part of the process? Or is the role of the rabbi somehow meaningful to the participants apart from the impact the rabbi has on the marriage transaction?

As a beetle turned entomologist, I find just as much explanatory power in seeing lawyers' involvement in the deal process as part of a ritual or ceremony that creates a physical contract, and which gives the parties some limited assurance of certainty in a highly uncertain and contingent world. I find it equally plausible that lawyers would continue to be present in deal making even if we found they do

10. *See* Jodi M. Solovy, *Civil Enforcement of Jewish Marriage and Divorce: Constitutional Accommodation of a Religious Mandate*, 45 DEPAUL L. REV. 493, 493–97, 511–522 (1996) (discussing *ketubot* (plural of *ketubah*) generally).

nothing to make the pie bigger. They are necessary, but it is at least as much in the value they bring to the individual clients, even if it comes at the cost of overall surplus and is otherwise not reducible to dollars. Their value might be in what they do to give the parties the courage to overcome fear, panic, seller's remorse, buyer's remorse, and risk averseness. Even more radically, are lawyers present not so much for any value at all, but for cultural or ritual significance?[11]

Professor Gilson might well concede all of this, but the implication is that there is something privileged about his particular method of explanation, and that is what I want to address. What do I mean by privileged status? In 1997, Nobel laureate Amartya Sen published an essay criticizing the foundations of rational actor theory, arguing that the prevailing rational theory of preference failed sufficiently to account for the behavior he termed "commitment."[12] Some years later, Eric Posner responded: "[S]imply assuming that people operate out of principle *and* rational calculation gives one less methodological purchase than the ordinary rational choice assumptions do, without, as far as I can tell, compensating for this loss by producing a methodological gain."[13] In short, if you cannot measure the variable sufficiently to prove the hypothesis, the hypothesis is not social scientific, and is therefore not entitled to privileged status as a contribution to social scientific knowledge.

My point is that Sen's concept of commitment or my theory of transactional lawyering may well not be privileged as a contribution to social scientific knowledge, but neither is Gilson's classic explanation of the value of lawyers to the transactional process. Robert Ellickson described the issue charitably as "creative tension between the yin of social-scientific universalizers and the yang of humanistic particularizers."[14] Gilson, I think it is fair to say, expects that his explanation is an instance of social-scientific universalizing. My suggestion is that it is at best on the borderline of science. To

11. *Cf.* Marc Suchman, *The Contract as Social Artifact*, 37 LAW & SOC'Y REV. 91 (2003).

12. *See* Amartya K. Sen, *Rational Fools: A Critique of the Behavioral Foundations of Economic Theory*, 6 PHIL. & PUB. AFF. 317 (1977) (a transcript of the Herbert Spencer Lecture, delivered at Oxford University in October, 1976).

13. ERIC A. POSNER, LAW AND SOCIAL NORMS 192 (2000).

14. Robert C. Ellickson, *The Twilight of Critical Theory: A Reply to Litowitz*, 15 YALE J. L. & HUMAN 333, 333 (2003). *See also* James Bohman, *Critical Theory as Practical Knowledge: Participants, Observers, and Critics*, *in* THE BLACKWELL GUIDE TO THE PHILOSOPHY OF THE SOCIAL SCIENCES 91–109 (Stephen P. Turner & Paul A. Roth eds., 2003).

resolve that issue, we need to revisit the demarcation issue: what distinguishes science from pseudo-science? Put another way, I am arguing conceptually that there is simply no way of ever proving or disproving the theory, and as such it loses its privileged status as a way in which scientific knowledge has progressed. As a way of making sense or explaining, it is no better—and perhaps worse—than cultural studies or hermeneutics (at least to the extent that those disciplines have not claimed privileged status for themselves as against other disciplines).[15] Again, I repeat, this is not a criticism of the creativity or the brilliance or the power of Gilson's explanation; it is merely a denial of its privileged status as scientific truth.

I suggest it is a fair project to review the best thinking about what science is, and to let the observer decide if the value-creation theory measures up. Professor Gilson acknowledges that "a truly empirical approach to measuring the impact of a business lawyer's participation seems impossible . . . ."[16] Nevertheless, his methodology is an interesting one. He accepts the capital asset pricing model, a theory that describes what factors ought to matter to buyers and sellers in valuing the asset to be sold. He then engages in a thought experiment, walking through the provisions of a typical acquisition agreement to determine whether, as a matter of reason rather than observation, there is a connection between what the agreement does and the factors in the capital asset pricing model.[17]

15. As Habermas observed, the methodology of empirical social science split off from the hermeneutical approach of "cultural and historical sciences" and the two disciplines barely speak. HABERMAS, *supra* note 2, at 2.

16. Gilson, *supra* note 1, at 247.

17. *See id.* Professor Gilson spends many pages on the information–exchange value of representations and warranties, and puzzles over the lack of any indemnification mechanism in public company deals (the representations and warranties expire at closing largely because once the proceeds in stock or cash are distributed to widely dispersed shareholders, there is no putting Humpty-Dumpty back together again). He acknowledges that indemnification may be partial or limited in time (there's also the "basket" or deductible, but he doesn't mention that), but the real questions, it seems to me, are: (a) whether backward-looking information in the representations and warranties is all that important to the deal, versus the softer forward information that is extra-contractual and conveyed by management presentations, plant tours, customer interviews, etc.; and (b) whether the actual instances of acting on the indemnification clauses warrant the investment in the representations and warranties, given that escrows may not be all that common. My guess is that representations and warranties have a certain amount of *in terrorem* effect, but neither of us has a whole lot of data to go on. Professor Gilson also extols the value-creating potential of the earn-out provision, but it's not clear to me that lawyers invented that concept, nor that earn-outs turned out to be very successful tools for compromise. The one empirical study of which I'm aware on this subject is by Steven Schwarcz, and it is based on surveys of clients who hire transactional lawyers. To quote Professor Schwarcz's SSRN abstract: "Contrary to existing scholarship, which is based mostly

"That is," Professor Gilson tells us, "it would be possible to inquire positively into the efficiency of the common 'lawyer.'"[18] Not surprisingly, he concluded that there is a connection, and enough of one to propose normative conclusions as to what lawyers should do if they want to enhance value.[19]

The first significant and influential theory of scientific demarcation was Popper's falsification principle. I will allow that Gilson's thesis cannot presently be falsified by empirical evidence for the very reasons Gilson suggests. I do not intend to use that as my basis for challenging its privileged status, because there are theories

on theory, this article shows that transactional lawyers add value primarily by reducing regulatory costs, thereby challenging the reigning models of transactional lawyers as 'transaction cost engineers' and 'reputational intermediaries.'" Steven L. Schwarcz, *Explaining the Value of Transactional Lawyering*, 12 STAN. J. L. BUS. & FIN. 486, 486 (2007).

18. Gilson, *supra* note 1, at 249.

19. If I were to apply an economic model to lawyers in deals it would be the Prisoner's Dilemma. Both clients would be better off cooperating by throwing all the lawyers out of the room for most of the issues in the deal, hence eliminating the transaction cost of arguing over myriad reps and warranties and other contract niceties that don't make any difference anyway. So imagine a Prisoner's Dilemma matrix with Party A and Party B, and the choice for each is "Lawyer" or "No Lawyer." The payoff for each side choosing "No Lawyer" is a huge reduction in costs (say, 5, 5) compared to both sides choosing "Lawyer" (say, 10, 10) But both sides keep their lawyers, for fear of the (1, 20) or (20, 1) outcomes in the Lawyer/No Lawyer boxes that are akin to one prisoner confessing but the other one not. Indeed, Professor Gilson alluded to this as a way perhaps of a rational explanation to the sociological question about the relative paucity of lawyers in Japanese business, albeit by way of comparison to American business. The standard explanation of cooperation in Prisoner's Dilemma games is repeat play, where the prisoners learn to trust each other and to cooperate to the optimum solution. *Id.* at 310, n.196. Professor Gilson speculates that in Japan the players have learned by repeated play that they will work out their future differences without opportunism. That means lawyers are simply not as important in that society. Professor Gilson wants to argue, I think, that American lawyers *actually* constrain opportunism by contract as much as Japanese culture *actually* eliminates opportunism. That means accepting the empirical assertion that American contracts actually constrain opportunism. (I have argued elsewhere that they do not, at least to the extent that future disputes involve the conflicting interpretations of language as to which there is no other dispositive evidence of "mutual intention." Jeffrey M. Lipshaw, *The Bewitchment of Intelligence: Language and Ex Post Illusions of Intention*, 78 TEMP. L. REV. 99 (2005).) What if the better explanation is that the Japanese business culture really is less opportunistic, and American lawyers indeed do not create value in transactions, but their presence in transactions is instead a rational game-theoretic response to what the sociologists would describe as American *gesellschaft* (modern organization) versus Japanese *gemeinschaft* (community)? *See* ALEX INKELES & DAVID H. SMITH, BECOMING MODERN 15–35 (1974). Indeed, it may well be that it is American culture that is exceptional in this regard. At least until the onset of globalized law firms, German contracts were also shorter, and—in the view of at least two other observers—explainable by a real difference in how the German business community viewed opportunism over cooperation. Claire A. Hill & Christopher King, *How Do German Contracts Do as Much with Fewer Words?*, 69 CHI.-KENT L. REV. 889, 898–99 (2004).

extant in the physical sciences that also cannot presently be falsified, nor is there any presently foreseeable means for learning how to falsify them. Instead, I propose "a tale of two theories" to demonstrate the point. The first theory is unquestionably scientific, but not presently falsifiable. Under the theory of genomic imprinting developed by David Haig, an evolutionary biologist at Harvard, certain conditions in pregnancy (*e.g.*, the condition known as preeclampsia) is the result of maternal-fetal conflict over uterine resources.[20] Natural selection theory suggests that paternal genes expressed in the fetus favor the survival of the fetus over the survival of the mother, whereas maternal genes so expressed would favor the survival of the mother over the fetus. The experimental evidence has shown that genes indeed carry an imprint marking whether they come from the mother or the father. Two non-geneticists have recently applied the Haig theory to mental disorders. Brain chemistry genes expressed from the mother tend to create sensitivity to mood in oneself and others: at the extreme, such genes create psychoses like schizophrenia and bipolar disorder. Genes expressed from the father tend to favor focus on patterns, objects, and systems over social development: at the extreme, Asperger's Syndrome or autism. There is presently no experimental methodology for testing this theory. Nevertheless, there does not seem to be any serious question that this is a contribution to science, not pseudo-science. The *New York Times* reported:

> "The reality, and I think both of the authors would agree, is that many of the details of their theory are going to be wrong; and it is, at this point, just a theory," said Dr. Matthew Belmonte, a neuroscientist at Cornell University. "But the idea is plausible. And it gives researchers a great opportunity for hypothesis generation, which I think can shake up the field in good ways."[21]

The economic value-creation theory, unlike the application of the genomic imprinting theory, is conceptually not falsifiable; it presupposes a particular belief—that economic actors would not act if they did not create societal economic value—in how the world must operate to make sense. The existence of a genomic marking that explains mental disorders is independent of a theory that might render it false. In contrast, economic value creation as posited by Professor

20. *See* DAVID HAIG, GENOMIC IMPRINTING AND KINSHIP (2002).

21. Benedict Carey, *In a Novel Theory of Mental Disorders, Parents' Genes Are in Competition*, N.Y. TIMES, Nov. 11, 2008, at D4, *available at* http://www.nytimes.com/2008/11/11/ health/research/11brain.html?_r=2.

Gilson is theory-laden in the sense that Ian Shapiro criticized in *The Flight from Reality in the Human Sciences*.[22] What comes first is the economic model and its assumptions about value and rationality, which is imposed on a linguistic exercise, which is in turn an imperfect model of a complex world. The economic theorist of human rationality would like the conclusion to have the patina of science, but it is not science. That is not to say it is without explanatory power, but that power is entitled to no greater deference as a contribution to scientific knowledge (rather than, say, belief or normative judgment) on account of science than hermeneutics, cultural studies, or philosophy. It is instead the social entomologist's delusion of objectivity. I suggest that we owe our transactional lawyers-in-training a more inclusive view of the possibilities of meaning and motivation in human affairs.

22. IAN SHAPIRO, THE FLIGHT FROM REALITY IN THE HUMAN SCIENCES (2005).