

ESSAY

DEALS: BRINGING CORPORATE TRANSACTIONS INTO THE LAW SCHOOL CLASSROOM

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I. THE *KARATE KID* METHOD

Law students are introduced to corporate transactions in much the same way Daniel LaRusso learns karate in *The Karate Kid*.¹ *The Karate Kid*, you may recall, is a heartwarming movie about courage and discipline. Sixteen-year-old Daniel LaRusso (played by Ralph Macchio) and his mother move to California, where Daniel has trouble adjusting to life at a new school and repeatedly gets beaten up by the jocks. Daniel then befriends Mr. Miyagi (Pat Morita) and studies karate under Miyagi's guidance. Miyagi teaches Daniel that the best way to fight is to control and channel his energy. Daniel overcomes his childish fear and anger with trained discipline and self-confidence. He ultimately faces down the jocks in a city-wide karate tournament, fights bravely, and wins the tournament.²

Daniel's relationship with Miyagi is the charm of the movie. When Daniel first shows up at Miyagi's house, he is put to work performing a series of household chores – painting the fence, waxing the cars in the driveway, sanding the floor, and so on. Unbeknownst to Daniel, Miyagi assigns these chores to train Daniel's muscle memory to perform basic karate moves. ("Wax on, wax off . . .") Just at the point when Daniel is ready to quit, Miyagi throws a punch; Daniel unconsciously parries the blow using the new skills

¹ *THE KARATE KID* (Columbia Pictures 1984).

² This being a Hollywood movie, in the end Daniel gets the girl as well (Elisabeth Shue).

he didn't even realize he had learned. It's the turning point in the movie, where Daniel learns to trust both his teacher and the value of the repetitive and grueling work.

The Karate Kid highlights the value of discipline and purity. Daniel learns karate piece-by-piece, with the focus always on the pure form of the ancient art. Miyagi shields Daniel from the sloppiness of actual fighting or even sparring against a live opponent. Not until the final scenes of the movie, where Daniel faces his enemies in the tournament, does he actually test his skills in combat.

Miyagi's focus on the pure form is great for the movies, but I wonder if it might be a bit risky in real life. The *Karate Kid* method removes the untidiness of a live opponent from the picture. How will Daniel hold up when he notices the bitter taste of adrenaline in his mouth as he enters the ring for the first time? It's a mystery until the end of the movie. As a moviegoer, I can accept as a matter of faith that Daniel will be able to translate his skills from the classroom into combat as a simple matter of discipline and courage. As an educator, I wouldn't be so sure. It seems foolish to expect a young karate student to go out and compete in a tournament without first bloodying his nose in the practice ring. It cuts against everything we know about how people learn and improve new skills.

The *Karate Kid* method is the conventional method for training law students to become lawyers. Law school is supposed to teach you to think like a lawyer. It actually teaches you to think like a law professor. Law professors usually teach what they know best: how to identify issues, absorb doctrine, parse the holdings of cases, argue intelligently about policy, and do a close reading of statutory language.³ Most graduates can then easily translate these

³ I may even be overstating the extent to which practical skills like reading a statute are taught. Close reading of statutory language is a skill most often taught in "practice-oriented" courses such as tax (especially corporate tax or partnership tax), bankruptcy, and secured transactions. In introductory courses, a student is much more likely to learn about the policy of a statute than she is to actually analyze related sections and subsections of a statute in the context of a legal problem.

skills into what we traditionally think of as the tasks of a lawyer: writing a bench memo, crafting an appellate brief, or researching a complicated statute.

So far so good. The problem is that in modern practice, and especially in a corporate transactional practice, a lawyer's daily tasks demand an additional set of skills. Thinking like a law professor will not help you identify, evaluate and manage business risks, structure agreements, negotiate terms, and draft and re-draft the documentation for complex financial transactions. Smart, hard-working law students may happen to become great transactional lawyers. But their professional success is only an indirect product of their law school training. Indeed, a majority of law students graduate without having once analyzed a prospectus, negotiated a term sheet, drafted a complex agreement, or, for that matter, even once having read a commercial contract from beginning to end. This may help explain why so many junior associates feel battered and bruised after they begin working at an actual law firm.

I don't mean to be overly negative about the state of affairs in legal education. Talented teachers make up for much of the deficit in hands-on training. Law schools are full of Mr. Miyagi – masters of the Socratic method who teach students how to think in a focused, sharp, and disciplined manner about complex problems. Bright law students graduate with sharp minds and a honed ability to learn more, and many do succeed quickly by learning on the job. But I do think law students should get a few chances to develop and practice transactional skills before graduation.

This Essay is addressed primarily to law professors, deans, and the legal education community, but I hope it also might be useful to students, practitioners, alumni, and others with a stake in how we are preparing the next generation of business lawyers in the United States. The Essay will offer some reasons why law schools rely so much on the *Karate Kid* method and will discuss how the Deals Program – developed by Columbia Law School Professors Ronald Gilson, Victor Goldberg, and David Schizer – brings corporate transactions into the classroom.

A. Three Obstacles to Narrowing the Gap

1. Lack of Conceptual Framework for Teaching Transactions

What is it, exactly, that business lawyers do? How can students be introduced to transactions in a coherent way, with consistent themes that apply to a wide range of transactions? Without a conceptual framework, it's hard to know exactly what to teach. Existing models for teaching transactions are often dry and tedious. Some law professors who see the value of teaching students about business transactions may fear getting bogged down in a paint-by-numbers approach in which students learn to find a form agreement and change the names of the parties. A good model for teaching transactions must ask the lawyer to add value to the deal and be more than a mere draftsman.

2. Lack of Teachers

There is a limited supply of law professors with the experience and inclination to teach transactions. Perhaps half of a typical law faculty has significant experience practicing law in a transactional area such as securities, M&A, tax, or bankruptcy. Of those who do have relevant practice experience, many may prefer to focus on advanced or specialized doctrinal courses rather than on laying the foundation for general corporate practice.

3. Lack of Quality Teaching Materials

To the extent transaction-oriented teaching materials exist at all, they tend to resemble a cookbook. It's not that difficult to find a model partnership agreement or loan agreement on the Internet. But once you have a transactional document, what can you do with it? Transactions need context and a lesson plan to be worth anything in the classroom.

B. Student Demand

Students crave deal experience. About 90 percent of Columbia Law School graduates work as corporate transactional lawyers or litigators with corporate clients within five years of graduation.⁴ Consider a typical law student who accepts a job at a large firm. She has spent perhaps 95 percent of her time in law school reading and discussing cases and law review articles. Once in practice, she will go days or weeks at a time without picking up a case or a law review article. Instead, her days will be filled with drafting, reviewing, and marking up transactional documents, negotiating language with opposing counsel, participating in conference calls, and composing memos, emails, and letters to colleagues and clients. Even if she becomes a litigator, the odds are still good that she will not spend a majority of her time on research and brief-writing. Rather, most of her time will be spent on fact development, preparing for depositions, and document production and review – each of which, like corporate practice, requires a solid understanding of financial deals and transactional documents. While this is an especially acute problem at Columbia and other top twenty-five law schools, where so many students end up in corporate practice, it is also true to a large extent at other schools that send significant numbers of graduates into corporate practice.

II. THE GAP AND THE DEALS SOLUTION

The American Bar Association established a Task Force in 1989 to "narrow the gap" between law school and law

⁴ This number is an estimate based on information obtained from the Columbia Law School Development Office, and it is consistent with my understanding of what my former classmates are doing and what current CLS students are planning to do. The percentage presumably decreases somewhat as many graduates, having paid off student loans, leave private practice to work in a non-legal capacity, work for the government, pursue public interest work, or enter academia.

practice.⁵ In 1992 the Task Force issued its report outlining the need for more clinical programs and skills-based coursework in law school. This gap between law school and law practice is well-known.⁶ Increasing numbers of law professors are paying attention to the problem of teaching transactional skills. Most often, the gap is addressed in the context of refining existing doctrinal courses in corporate and business law.⁷

⁵ See Robert MacCrate, *Report of The Task Force on Law Schools and the Profession: Narrowing the Gap; Legal Education and Professional Development – an Educational Continuum*, 1992 A.B.A. SEC. ON LEGAL EDUC. AND ADMISSIONS TO THE BAR (also known as the "MacCrate Report" after the section's Chairperson, Robert MacCrate).

⁶ A sampling of the academic literature includes: Harry T. Edwards, *The Growing Disjunction Between Legal Education and the Legal Profession*, 91 MICH. L. REV. 34 (1992) (calling for a healthy balance of theory and doctrine and a focus on the training of practicing lawyers); Daniel Gordon, *Does Law Teaching Have Meaning? Teaching Effectiveness, Gauging Alumni Competence, and the MacCrate Report*, 25 FORDHAM URB. L.J. 43 (1997) (arguing that the focus of reform should be on improving teaching effectiveness rather than on wholesale changes in the curriculum); Alex M. Johnson, Jr., *Think Like a Lawyer, Work Like a Machine: The Dissonance Between Law School and Law Practice*, 64 S. CAL. L. REV. 1231 (1991) (calling for more traditional doctrine-oriented law teaching).

⁷ A recent symposium at the University of Georgia focused on different approaches to teaching corporate law. Some of the useful articles include: William J. Carney, *Preparing the Corporate Lawyer: Teaching Problems in Corporate Law: Making it Real*, 34 GA. L. REV. 823 (2000) (describing the benefits of "Problem Method" exercises); James A. Fanto, *When Those Who Do Teach: The Consequences of Law Firm Education for Business Law Education*, 34 GA. L. REV. 839 (2000) (urging law professors to learn strategies from in-house training methods); Jill E. Fisch, *Teaching Corporate Governance Through Shareholder Litigation*, 34 GA. L. REV. 745 (2000) (focusing on the role of litigation in setting norms of corporate behavior); Carol R. Goforth, *Use of Simulations and Client-Based Exercises in the Basic Course*, 34 GA. L. REV. 851 (2000) (describing use of negotiation and drafting simulations); Therese Maynard, *Teaching Professionalism: The Lawyer as a Professional*, 34 GA. L. REV. 895 (2000) (describing qualities of good business lawyers and strategies for imparting professionalism); Charles R. T. O'Kelley, *Delaware Corporation Law and Transaction Cost Engineering*, 34 GA. L. REV. 929 (2000) (describing the organization of his Corporations course around Delaware Corporate Law

The Deals approach is Columbia's attempt to narrow the gap and put theory into action. The core principle that we start with is the idea that – unlike in *The Karate Kid* – everything you learn in the classroom changes in the real world. Theory is a useful place to start, but as a lawyer you must focus on those aspects where theory breaks down.⁸

The Deals approach thus accepts and embraces the fact that we live in an imperfect world. Our world is full of transaction costs. Information is costly and difficult to obtain. People sometimes lie, cheat, and steal. Legal and non-legal rules handcuff the invisible hand of the free market. Human nature and honest mistakes limit the ability of people to contract in the "ideal" efficient manner. The messy reality of how human beings actually interact breaks down the utility of the theoretical solutions of introductory law classes. It is in this realm that lawyers do their most important work. The Deals approach categorizes the recurring problems that appear in different types of real world transactions. We then challenge students to apply their intellectual skills to solve these problems by examining and applying the solutions found in other deals.

The Deals program does not propose a fundamental reform of the legal education system away from a doctrine-oriented curriculum. Nor is the Deals program devoid of

as a coherent system rather than a series of conflicting doctrines); Richard W. Painter, *Professional Responsibility Rules as Implied Contract Terms*, 34 GA. L. REV. 953 (2000) (exploring the connection between lawyers' ethics and lawyers' economic relationships); Edward Rock & Michael Wachter, *Fiduciary Duty, Limited Liability, and the Law of Delaware: Corporate Law as a Facilitator of Self Governance*, 34 GA. L. REV. 529 (2000) (arguing that firms are governed primarily by "norms" rather than "law");

⁸ Thus, for example, the Efficient Market Hypothesis is a useful place to start analyzing securities law. The lesson is incomplete, however, until you acknowledge the limitations of the theory and start to examine why the theory breaks down in the real world. The Coase Theorem's world-without-transaction-costs is a useful introduction into how law does or does not affect property rights, but the lesson is incomplete until you examine why transaction costs do affect the allocation of property, and what you, as a lawyer, can do about it.

theory; rather, it supplies a theoretical framework for analyzing deals and creating value. We recognize that Deals students must first develop a sound ability to think critically and a rough understanding of the legal background in which deals take place.

A. Creating a Conceptual Framework

Modern corporate financial transactions are intimidating. The documentation for a typical corporate merger, debt offering, credit agreement, or asset securitization often runs well over a hundred pages. Just figuring out the cash flows and economics of a transaction is scary enough: Most JDs do not have an MBA, and many have little, if any financial background. Add in the legal and regulatory complexity of a deal, and it becomes downright terrifying. First-year and second-year law firm associates exert a lot of misspent effort because they lack a basic understanding of why corporate documents look the way they do. Faced with a sink-or-swim reality, a junior associate will cling to a precedent as a life preserver. This is done not just as a matter of efficiency. Forms and precedents are undoubtedly the backbone of corporate practice and there is often no reason to start from scratch. But junior associates have a tendency to stick too closely to precedents and retain unnecessary or inefficient terms because they are unfamiliar with the structure of the documents or do not trust their own judgment.⁹ New lawyers do not know how to swim on their own; they have studied the backstroke, the breaststroke, the crawl, and the butterfly, but they haven't spent any time in the water.¹⁰

⁹ As a new associate, my own work improved by working closely with partners and by muscling through dense documents on my own. Clearly some of this learning could have come in law school. I had the additional benefit of working in the tax department at Davis Polk, where there is typically only one partner and one associate on each deal, and there is also a culture of talking through problems before turning to documentation.

¹⁰ As my colleague Bill Savitt pointed out to me, the more precise analogy is even worse: it is as if we are teaching students First Principles of Buoyancy and The Changing Perspectives of Water: Liquid, Solid, and

So why is it so difficult to bring transactions into the classroom? To begin with, it is not self-evident what should be taught. There is no widely-accepted conceptual framework to explain how and why deals happen the way that they do. Given the myriad ways that parties can organize their private deals within the constraints of the law, why do they choose one form over another? A proper analysis of the business lawyer's role requires looking beyond the traditional conception of law as a compilation of statutory and judge-made rules. A business lawyer must tackle all the risks, legal and non-legal, which can and should be addressed by the documents being drafted.

Think about a typical corporate agreement, such as a stock purchase agreement. For every clause in an agreement designed to comply with a legal rule, there are five or ten clauses that describe how the parties are allocating business risks. All the clauses – legal or business – are to some extent negotiated and drafted by lawyers. A conceptual framework must account for the fact that lawyers spend most of their time thinking about questions that we don't normally describe as legal questions. Existing models for teaching transactions are inadequate.

1. The CLE Model

The most common model for teaching transactions, the continuing legal education seminar, is not an appropriate introduction to transactional work. A presenter (usually an expert practitioner) describes a hypothetical transaction. She describes each step of the transaction; at each step she identifies possible "red flags" or issues to be aware of. Reference may be made to business risks and non-legal issues, but the focus is usually centered on how recent cases or statutory changes require some modification to existing form agreements or precedents. Participants may also receive written materials that they can put on their shelf and refer to as necessary. When law firms do their own in-

Gas . . . and then shoving them overboard into shark-infested waters and demanding a synchronized swimming routine.

house training of junior associates, they tend to follow this model, perhaps with particular focus on the firms' clients or specialized practice areas.

The CLE model is best suited for someone who already has experience doing deals. It can be an effective way to refine knowledge of an area and build on the basics one has already obtained in practice. But it would not be the best way for a law student to get introduced to corporate transactions. Without a conceptual framework, students find it tricky to figure out how lessons learned from a close study of one transaction might apply to the next type of transaction. The CLE model provides a detailed look at a few trees but no view of the forest.

2. The Clinical Model

Another model is the clinical approach. At most law schools students can take clinical courses geared toward a particular area of law, such as non-profit organizations, environmental law, prisoners' rights, or low-income housing. Under the supervision of clinical faculty, students represent real clients. Although most clinics are litigation-oriented, some include a transactional element where students negotiate and draft relatively simple agreements like residential leases.

One problem with extending the clinical model to complex financial transactions is that corporate documents are burdened with financial jargon and a lack of transparency that makes them especially confusing to the uninitiated. I would expect a third-year law student to be able to figure out most of a not-for-profit corporation's 501(c)(3) application for tax-exempt status on her own with minimal supervision. I would not expect a student to draft a good stock purchase agreement without extensive training and supervision. Another problem with extending the clinical model to financial transactions is practical: there are no clients. No

client would entrust a multi-million dollar transaction to law students.¹¹

3. The On-the-Job Model

Finally, there is learning on the job – the solution that, by default, most law firms use. Most law schools teach the basics of the underlying legal doctrine and produce graduates who lack transactional skills. Junior associates get some guidance from in-house training sessions, but the bulk of their learning comes from experience. Somehow, in the midst of fourteen-hour days, associates are expected to take a step back and think about how the current transaction differs from the last and why that might be so, and then carry the lesson forward to the next transaction. For some lawyers on-the-job learning works well, but for others it is more problematic. Moreover, law firms (or their clients) bear the cost of this education; this is a real social cost that should not be ignored. Another social cost is deeply troubling: Starting out in corporate practice is more disorienting and frustrating than necessary because of the alien nature of financial documents, and many associates quickly become resigned to thinking of themselves as paper-chasing drones. I honestly believe this helps explain the tendency of lawyers to become unhappy and resentful towards what they do. A little introduction to the theory of transactions while in law school might help ease the pain.

¹¹ Similarly, negotiation workshops help solve one aspect of the problem by building a foundation of negotiating skills. But negotiation is just one aspect of transactional practice, and general negotiation principles do not always translate well into the type of negotiation a lawyer working on a complex financial transaction will engage in. It is one thing to negotiate a divorce agreement and quite another to negotiate a rider to an interest rate swap agreement. Negotiating either one is difficult; negotiating the latter requires a specialized understanding of financial concepts and business risks.

4. The Deals Model: Transaction Cost Engineering

The Deals approach provides a conceptual framework for teaching transactions. The Deals course, created by Ron Gilson and Victor Goldberg, centers largely around concepts first articulated in Gilson's 1984 *Yale Law Journal* article, *Value Creation by Business Lawyers: Legal Skills and Asset Pricing*.¹² In the article Gilson describes the concept of Transaction Cost Engineering, which he views as the primary role of the business lawyer.

Gilson sets out to answer the question: "What do business lawyers do?" The conventional wisdom then, as now, is that business lawyers are merely a transaction cost to be endured, a necessary evil. Gilson explains,

Business lawyers are seen at best as a transaction cost, part of a system of wealth redistribution from clients to lawyers; legal fees represent a tax on business transactions to provide an income maintenance program for lawyers. At worst, lawyers are seen as deal killers whose continual raising of obstacles, without commensurate effort at finding solutions, ultimately causes transactions to collapse under their own weight.¹³

Gilson counters the conventional wisdom with a view of the business lawyer as Transaction Cost Engineer. Briefly, Gilson argues that business lawyers add value to deals by managing transaction costs. Deals are varied in their specific subject matter: a company may buy a piece of equipment, hire a CEO, invest in a joint venture, or spin off a subsidiary. But certain transaction cost problems recur in every deal. One party has more information than the other, which leads to a lack of trust and cooperation. The value of the assets is uncertain. The parties differ in their assessment of and appetite for risk. The value of the project

¹² Ronald J. Gilson, *Value Creation by Business Lawyers: Legal Skills and Asset Pricing*, 94 *YALE L.J.* 239 (1984).

¹³ *Id.* at 241-42.

is affected by the behavior of those who manage or control the project. Gilson's point is that these transaction costs recur in every deal, and it is the lawyers' job to manage or "engineer" these transaction costs by structuring agreements and drafting contract language to address these problems in a way that creates the most value for the deal as a whole and for their client.

Gilson illustrates the point by focusing on the sale of a capital asset. Many corporate deals involve the pricing and transfer of all or part of a capital asset, whether the asset is a piece of equipment, an investment in a partnership, or the sale of an entire firm. Gilson chooses as a starting point of analysis the Capital Asset Pricing Model, an economic theory which demonstrates that the free market will naturally price assets in an efficient and accurate manner if the following assumptions are made:

1. All investors have a common time horizon—i.e., they measure the return to be earned from the asset in question over the same period of time.
2. All investors have the same expectations about the future, in particular, about the future risk and return associated with the asset in question.
3. There are no transaction costs.
4. All information is costlessly available to all investors.¹⁴

Of course, in the real world, none of these assumptions are true – and that's where the lawyers come in. Suppose Amazon is buying a small internet startup that has written a series of new software programs to manage inventory. The value-creating role of the business lawyer is to address the particulars of the deal and help the client reach the appropriate price on the deal. So, because information is costly, counsel for Amazon and counsel for the startup will negotiate for the production and transfer of as much information as possible about the startup's business, until the cost of producing the information starts to exceed its utility to Amazon. For some questions, such as whether the

¹⁴ *Id.* at 252.

startup has followed all the proper corporate formalities, a legal opinion by the startup's counsel may be the most efficient way to produce and transmit the information. For other questions, such as the effectiveness of the software program, Amazon's counsel may arrange for the Amazon software engineers to test the program. Or she may arrange for interviews with the startup's engineers. Or she may suggest that a portion of the purchase price be made contingent on the success of the product. Every solution for every deal will be different depending on the specific characteristics of each party – and the lawyer's job is to evaluate the business risks and the client's characteristics, and then design an efficient and appropriate solution (and negotiate for and draft appropriate language to effect the solution).¹⁵

The Deals faculty draws heavily on the law and economics literature. Deals co-founder Victor Goldberg's work reinterprets traditional contract law analysis to focus on the role of private arrangements in encouraging efficient production of information and proper valuation of assets, and regulating the incentives of the parties.¹⁶ Goldberg focuses on the law and economics concepts of information asymmetry, moral hazard, adverse selection, signaling,

¹⁵ Or, to choose another example, the buyer may have a strong appetite for risk and be especially interested in the upside potential of the firm. Counsel may want to design a financing arrangement that provides for financing in stages, so that the investor can evaluate the firm before sinking too much money – thus lessening the need for information at the first stage of the investment.

¹⁶ See, e.g., Victor P. Goldberg, *Discretion in Long-Term Open Quantity Contracts: Reigning in Good Faith*, 35 U.C. DAVIS L. REV. 319 (2002) (analyzing courts' abuse of "good faith" in contracts cases); Victor P. Goldberg, *In Search of Best Efforts: Reinterpreting Bloor v. Falstaff*, 44 ST. LOUIS U. L.J. 1465 (2000) (reinterpreting classic contract case as exit agreement rather than distribution agreement); Victor P. Goldberg, *Price Adjustment in Long-Term Contracts*, 1985 WIS. L. REV. 527 (analyzing contracts as seeking benefits of cooperation rather than mere technique for risk-avoidance); Victor P. Goldberg, *The Net Profits Puzzle*, 97 COLUM. L. REV. 524 (1997) (analyzing contingent compensation in the movie industry).

shirking, and so on. But although law and economics jargon is used, the Deals world is not a pure economics world without transaction costs – rather it is law in a world full of transaction costs, where the lawyer must address the problems that the economist would assume away.

The Deals approach also draws on the work of David Schizer, who co-taught the Columbia Deals Class in the Fall of 2001. Schizer's scholarship focuses on the interaction between tax and corporate governance, among other things examining how legal regimes (tax and otherwise) may treat the same economic deal differently based on formal modification.¹⁷ Formal modification may affect the economics of the transaction greatly or not at all; the lawyer creates value for the client by engineering a set of legal forms and relationships that minimizes legal, tax, and regulatory costs while coming closest to the economic deal sought by the parties. In other words, the lawyer must assess the consequences of choosing one legal form over another, and then must investigate whether there are non-legal "frictions" that restrict or prevent the choice of certain formal structures.

5. The Deals Class

For those who are interested in how the conceptual framework is adapted to the classroom, a description of the mechanics of the Deals Class may be useful. Professors Gilson and Goldberg have taught the Deals Class at

¹⁷ See, e.g., David M. Schizer, *Executives and Hedging: The Fragile Legal Foundation of Incentive Compatibility*, 100 COLUM. L. REV. 440 (2000) (evaluating effectiveness of legal constraints on hedging by executives); David M. Schizer, *Frictions as a Constraint on Tax Planning*, 101 COLUM. L. REV. 1312 (2001) (describing how financial accounting and other non-legal transaction costs constrain tax planning); David M. Schizer, *Sticks and Snakes: Derivatives and Curtailing Aggressive Tax Planning*, 73 S. CAL. L. REV. 1339 (2000) (describing problems with past reform attempts aimed at tax planning and ways to improve future attempts); David M. Schizer, *Tax Constraints on Indexed Options*, 149 U. PA. L. REV. 1941 (2001) (explaining tax disadvantages of compensating employees with indexed options).

Columbia Law School since 1994. Professor Schizer co-taught the class with Professor Goldberg in the Fall of 2001; Professor Schizer and I will co-teach a second section of the course in Fall 2002. Student reaction to the Deals class has been very positive; for years it has been a very difficult class to get into, with sixty students in the class and a waitlist often exceeding ninety students. Of the sixty students, ten to fifteen are MBAs or JD/MBAs.

The Deals class is structured as follows. In the first half of the course, students hear a series of lectures describing how lawyers can manage deal-related problems – how earnout structures address the uncertain value of an asset; how stock options incentivize employees and affect risk preference; how a leveraged buyout affects management structure, and so on. In other words, the concepts of option theory, moral hazard, adverse selection, rent-seeking, etc. are addressed in the context of real transactions. Readings include law review articles, case studies, and just a handful of appellate cases. Some Socratic method is used, particularly when case studies are discussed. Students are asked to assume the role of the deal lawyer and explain how they might tackle the problem.

In the second half of the course, the Transaction Cost Engineering framework is applied to several deals using actual deal documents. There are two two-hour sessions per week. During the first class each week, the group of students assigned to that week's deal presents it to the class, using the Deals terminology to explain how it was structured and why it was structured that way, and raises questions about terms that seem to be anomalous or inefficient or inappropriate for the deal. During the second class each week, the actual lawyers or principals who worked on the deal come to the class to give their view of why they structured the deal the way that they did, and to answer the students' (and professors') questions. The process is repeated each week with different deals. Thus, for example, in the fall of 2001 the Deals class analyzed a venture capital financing for an Internet company, a tracking stock offering for an Internet subsidiary, a leveraged recapitalization, a

mezzanine debt offering, and the private/public financing of a nuclear waste clean-up project. Other past deals have included a movie financing, an asset securitization, a variable-delivery forward contract, a French company's sale of a subsidiary, and an agricultural research and development joint venture.

6. The Deals Workshop

We have extended the Deals Program to a skills-oriented class called "Deals Workshop: Art of the Deal." I am currently teaching the Workshop; the students are mostly third-year JDs, along with a few foreign LL.Ms, some of whom have practiced law abroad. The Workshop begins with the basics of Transaction Cost Engineering and then asks students to apply the theory to case studies and simulated problems. Students analyze and discuss such deals as the sale of a coffee shop business, an investment in a service firm that rates securities analysts, a music industry recording contract, an ISDA swap agreement, and a venture capital financing. Students also complete a series of client memos and simulated negotiation and drafting problems related to these agreements.

7. Normative Appeal of the Deals Model

Transaction Cost Engineering is an especially useful way to teach transactions because it provides a positive outlook and description of what business lawyers actually do. Many students finish law school with only the vaguest notion of what they will be doing. They know that long hours will be spent at the mysterious printer, that car service will be provided to get home, and that the wine at closing dinners will likely be expensive and French. They have been warned that the actual day-to-day is a far cry from the research memos and long lunches which characterize the summer associate experience. But law schools certainly do not provide much insight into what a day in the life of a corporate lawyer is like. The framework of Transaction Cost

Engineering should make the transition from law school to law firm a more positive one. No longer must a lawyer view herself as a mere draftsman or hired gun. The Deals Program instead grooms value-creating "transaction cost engineers" armed with a basic understanding of financial transactions and a leg up in analyzing and managing their clients' business risks in an effective manner.

B. Leveraging the Work of the Deals Faculty

The second hurdle to teaching corporate transactions effectively is finding enough qualified teachers who are willing to engage in work that, to be most effective, requires close supervision and line-editing of students' work. Teaching transactions is labor-intensive and may be unattractive to those accustomed to think of transactional courses as anti-intellectual or CLE-oriented. In law firms, associates learn by discussing their work with the partners working on the deal and by seeing their drafts marked up by partners and/or more senior associates. It's challenging to try to replicate that in the classroom; most large law firms are leveraged by an associate-partner ratio of no more than four-to-one. Given student demand, a small team of qualified Deals teachers would be ideal.

Our current solution of teaching transactions through the Deals Class and Deals Workshop is a partial solution.¹⁸ By keeping enrollment at a manageable level in both the Class and the Workshop, there is time for some personalized attention and more free-form discussion and questions. In the Class, students break into small groups in the second half of the class, focusing their efforts on analyzing and writing a presentation and paper for their deal. For the Workshop, enrollment is limited to twenty-four students,

¹⁸ It may also be possible for professors to integrate transactional skills exercises into some upper-level courses. For example, this semester David Schizer added several classes to his Taxation of Financial Instruments course in which students reviewed prospectuses from actual deals and analyzed the tax treatment.

and we may limit enrollment to twelve or sixteen in the future to increase personal attention.

We also use technology to help. In the Workshop, weekly assignments are distributed by email, with background material included as attachments. Students must email back their work each week the night before class. A podium computer patched into the school's network allows us to review student work in class on an overhead screen with capability to cut, paste and edit as appropriate. The network also allows us to integrate deal documents, summaries or diagrams into PowerPoint presentations.

Nevertheless we have a ways to go before meeting student demand. The waitlist for this semester's Workshop exceeded eighty students, so several small workshops would be ideal. In the future, we hope to leverage the Deals Workshop by using alumni practitioners as adjunct professors. With a standardized set of course materials from the Deals Workshop focused around the conceptual framework of Transaction Cost Engineering, we plan to offer several sections of the Workshop to help meet student demand while still providing a consistent and pedagogically sound approach to the problem.

C. Creating quality teaching materials

Another related obstacle to teaching transactions is the lack of quality teaching materials. There are virtually no textbooks geared toward teaching transactional skills; there are none specifically focused on sophisticated financial transactions. The lack of teaching materials is especially troublesome because it makes class preparation, already a labor-intensive process, even more time-consuming. Our solution here has been to borrow the case-study method used in business schools.

1. B-School Lite

Many transaction-oriented skills require a basic understanding of concepts taught in business schools. After all, investment bankers and other MBAs often negotiate and

design the basic economic structure of deals before turning over the term sheets to the lawyers. Hence it makes sense to teach some of the same lessons that business school students receive. I sometimes describe this part of the Deals course as B-School Lite. By B-School Lite I mean that we provide students with a more user-friendly, accessible, somewhat simplified version of some of the financial concepts taught in business school. The Deals courses do not purport to make students into finance wizards or to substitute for business school, but rather to familiarize students with fundamental economic concepts and goals and the common terminology that their corporate clients will use.

2. Case Studies

We are finding that an effective way to introduce financial concepts into the law school classroom is through a mix of the case study method and Deals theory. Most business schools rely on the case-study method to illustrate economic principles. So, rather than learning about mergers in a vacuum, business school students might read about Hewlett-Packard's proposed merger with Compaq, or Exxon's merger with Mobil. To work in the law school classroom, business school case studies must be adapted; they tend to have more focus on numbers than is ideal for our purposes.

For example, the first case study used in this semester's Deals Workshop examined "Streetwatch," a (hypothetical) new business that ranks sell-side securities analysts for institutional investors. The CEO of Streetwatch, Dan Jennings, must choose between two means of financing his growing venture. The first offer, from the publisher Institutional Investor, would offer Jennings a stable source of capital for his business and potential reputational synergies, and would pay him a nice salary, but would limit his upside equity potential. The second offer, from a venture capitalist, would offer Jennings unlimited upside equity potential but would create a greater risk to his personal investment in the firm, his job as CEO, and the Streetwatch business. The case thus invites students to evaluate and balance the risk and reward of each choice, both to Jennings

personally and to the Streetwatch business. The case highlights the classic problem of agency costs – that Jennings, as the manager in control of the firm, may act in his own best interest to the detriment of the other stakeholders in the firm. And the case examines different ways that each investor would try to address the agency costs problem. The questions accompanying the case ask the students to assume the role of Jennings' lawyer, analyze different aspects of the term sheets from each investor and figure out how the different business risks would affect their advice to Jennings. Other case studies include transactional documents in addition to term sheets, such as employment contracts, shareholders' agreements, articles of incorporation, and stock purchase agreements.

3. Research Fellows

One cause of the lack of quality teaching materials is the relative lack of research fellows in law schools. In most academic disciplines, graduate students and research assistants help the faculty with at least some of their most labor-intensive tasks, such as empirical research, running discussion groups, grading papers, or primary source research. Law schools, on the other hand, employ graduates for only one such task – teaching legal research and writing to first-year law students. Organizing and teaching transactions would seem to be ideal work for recent graduates with a few years' experience under their belts. So why don't we see more research fellows teaching transactions?

For one thing, the path to teaching does not require an advanced degree in law, so there may be a relatively small supply of qualified research fellows. Business lawyers who are interested in teaching can simply enter the academic job market. There is also a financial disincentive which is particularly acute for finding potential graduate students or fellows interested in corporate transactions: research fellows typically would receive a fraction of what they might earn as a fourth- or fifth-year associate at a large firm.

The solution at Columbia Law School (again, a partial one) has been to create a fellowship in Transactional Studies. Rather than seek a tenure-track position this year, as the Inaugural Fellow in Transactional Studies I have agreed to spend two years organizing course materials, teaching the Deals Workshop, and researching and writing case studies. In return, I have a chance to develop my scholarship and research agenda and achieve a better range of options than had I had entered the teaching market directly from a harried corporate practice. Given the labor-intensive nature of teaching transactions, other schools may want to follow the model, which is already used for teaching the basics of legal research and writing: to find and fund research fellowships to fill the gap and leverage the work of the tenured faculty.

III. CONCLUSION

This Essay has described Columbia Law School's approach to tackling the problem of bringing corporate transactions into the classroom. While the Deals model may not fit every school's needs, it provides a pedagogically sound and effective method for improving the training of corporate lawyers and narrowing the gap between law school and law practice.

The Columbia Business Law Review has agreed to partner with the Transactional Studies Program in our effort to promote the teaching of transactions. The Business Law Review will periodically publish case studies as part of the Columbia Law School Transactional Studies Program Case Series, thereby making them available to the legal community at large. Case studies will also be made available on the Deals webpage, <http://www.law.columbia.edu/deals>, and on the Social Science Research Network, <http://www.SSRN.com>.

