The Law as Instrument of Corporate Strategy: A Study of Legal and Political Astuteness in Globalized and Regulated Industries

By
Marcelo L. Garcia

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Table of Contents

Introduction

In the last thirty years, industrialized economies have witnessed an increase in the complexity of government regulation due, in part, to the internationalization of business and the rise of information technologies. More recently, the emergence of 24-hour news networks has increased the exposure of corporations to public scrutiny, thus forcing governments to legislate – sometimes – in a chaotic and reactive fashion. In light of this, senior executives have become aware of the importance to integrate legal and political elements in their broader corporate strategy. In other words, they have accepted that issues and actors beyond markets can affect their bottom line and, consequently, that they should be managed.

So far, most corporate responses to government intervention and regulatory complexity have included tactics such as lobbying, strategic litigation, and public relations campaigns. These approaches have generally assumed that firms can influence the legal and political arenas, and consequently, modify the firm's competitive environment. Over the years, many firms have come to perceive the "government affairs" function as a strategic core competency worth investing in, especially in heavily regulated industries such as airlines, banking, energy, telecommunications, and pharmaceuticals. The ability of firms to link up their political strategies with their core business and overall corporate strategy can be termed as **political astuteness**. The political astuteness realm recognizes that businesses are social and political beings – not just economic agents.

In recent years, however, it has been suggested that regulated firms should embrace a proactive approach to the management of legal and political issues. According to this view, firms should go beyond mere compliance with the letter of the law. They should convert regulatory constraints into business opportunities. From a legal perspective, this paradigm change means perceiving the law as malleable and dynamic rather than static and supreme. From a strategic perspective, it means seizing fleeting opportunities emerging from the legal sphere in order to succeed, regardless of whether firms already possessed superior resources or inherited favourable strategic positions. Under the proactive approach, senior managers and their lawyers are invited to create value through continuous regulatory environment scanning. **This thesis suggests that the process of scanning requires not only superior legal technical expertise, but also a good knowledge – and understanding – of the regulatory and political landscape on which firms evolve (Chapter 5).**

It has also been contended that a proactive approach to legal risk management can become a valuable firm capability, and ultimately, a source of sustained competitive advantage. For many global firms, minimizing legal risks and reducing transaction costs when entering foreign markets is indeed a top priority. In many cases, the failure to identify legal risks can trigger the collapse of what initially seemed like an excellent business opportunity. From an organizational perspective, legal risk management is primarily concerned with the integration of law into corporate strategy and internal planning. Compliance departments are a good illustration of this type of integration. From a proactive standpoint, however, legal risk management involves the development and accumulation of legal resources inside the firm. These resources can be used to reduce transaction costs, to prevent competition, and most importantly, to ensure that firms acquire or maintain a sustained competitive advantage. Examples of legal resources may include intellectual property portfolios, multi-jurisdictional contractual arrangements, and cascading corporate structures.

Under the proactive approach, lawyers are expected to become creative designers of legal resources. **This study contends that the development of effective legal risk management systems and the optimization of legal resources may necessitate the establishment of strategic alliances based on natural complementarities (Chapter 4)**.

I. Lawyers as Central Players in Corporate Strategy and Decision-Making

International speaker Richard Susskind has recently suggested that large business law firms are gradually losing relevance in the current marketplace as their services become mere commodities. He identifies information technologies (IT) as the number one suspect triggering this systemic trend. The market, he contends, "is increasingly unlikely to tolerate expensive lawyers for tasks (guiding, advising, drafting, researching, problem-solving, and more) that can equally or better be discharged by less expert people, supported by sophisticated systems and processes"[1]. He claims having discussed with dozens of company lawyers all around the world during his speaking engagements. He summarizes his interactions as follows: "I was struck by how seldom these corporate counsel spoke about law firms (...) the law firms that serve them were not discussed very much at all, and certainly not as central players. They were spoken of, respectfully as a general rule, but as a pool of service providers at the edge rather than as key players at the core"[2]. More importantly, Susskind suggests that legal professionals should "identify their distinctive skills and talents, the capabilities they possess that cannot, crudely, be replaced by advanced systems, or by less costly workers supported by technology or standard processes"[3].

Perhaps the most consequential point raised by Susskind is that company lawyers do not identify external lawyers as being central players in the formulation and implementation of

[1] Richard Susskind, *The End of Lawyers? Rethinking the Nature of Legal Services* (Oxford, UK: Oxford University Press, 2008) at 2 [Susskind, *The End of Lawyers*].

[2] *Ibid.* at 147.

[3] *Ibid.* at 2.

business strategy and decision-making. This thesis intends, in a way, to explore this apparent divide by suggesting that senior management teams should also integrate the law into the development of core business strategies. This attitude is referred to as **legal astuteness**, namely the ability of the top management team to call on their lawyers to play an active and ongoing role in the formulating and executing of firm strategy. Legally astute firms understand the importance of law as a strategic tool to achieve sustained competitive advantage. Legally astute teams do not perceive the law as a financial burden or "necessary evil". Instead, they adopt a proactive approach to government regulation and ask their lawyers to help them take advantage of the business opportunities that new legislation may offer. Last but not least, legally astute managers do not treat their lawyers as technical consultants to be brought in on an intervallic basis or whenever the corporation is facing a specific legal problem or after having adopted the firm's business strategy.

This thesis puts forward the view that lawyers – and some of their professional tools, namely legal systems, processes, frameworks – can be valuable sources of competitive advantage when a blend of highly specialized technical knowledge and business judgment is required. Inexpensive labour supported by technology or standard processes cannot and will never replace judgment and problem-solving skills. In a fast-paced economy, advanced systems cannot frame, analyze, or anticipate changing external conditions. Under the proactive approach, legal professionals remain important resources for those firms seeking to enter foreign markets and protect their valuable intangible property. They can also play important roles in those industries whose activities are heavily regulated by governmental authorities at all levels.

II. Roadmap: The Role of Legal and Political Astuteness in Corporate Strategy

Chapter 2 provides a comprehensive review of current theories on legal and political action from a managerial perspective. It also addresses the internal dynamics of the business-government interface and the impact of regulatory activity on the competitive landscape of firms. It will also

introduce the embryonic field of law and management, and particularly discuss the nascent body of literature led by Constance Bagley of Harvard Business School. This body of literature generally posits that firms can achieve sustained competitive advantage and improve their overall performance by incorporating various legal systems, processes and players into their broader business strategy.

Chapter 3 notes that firms using their internal legal resources and inherent capabilities may achieve high levels of competitive advantage, but only in certain situations. Borrowing on the resource-based view of the firm, it is contended that corporations can attain higher levels of sustained competitive advantage by combining resources – valuable, rare, inimitable and nonsubstitutable. They can do so by establishing strategic alliances with legal entities in their immediate nonmarket environment. As will be demonstrated in Chapter 4, the resulting alliances are attractive vehicles for enhancing current resource bundles, decreasing transaction costs, increasing strategic flexibility, and reducing legal risks.

Chapter 4 will analyze the legal and institutional aspects behind the commercialization of the Olympic brand. In particular, it will unveil the governance structure that supports the ongoing commercial relationship between the Olympic family and its global corporate sponsors. It will be contended that the strategic alliance between global sponsors and the International Olympic Committee (IOC) is in itself a source of sustained competitive advantage. In fact, the valuable, unique, and inimitable synergy created by this alliance has permitted the effective management of various legal risks associated with sport sponsorship contracts. For example, the imitation or partial appropriation of trademarks, ambush marketing campaigns, and counterfeiting. Finally, it will be suggested that strategic alliances based on legal resource complementarity can be excellent vehicles for those legally astute teams – and proactive lawyers – seeking to institutionalize and maintain their firm's competitive advantage in the global marketplace.

Chapter 5 presents the case of a regional start-up airline that managed to leverage the legal and political astuteness of its top management team (TMT) – and its Toronto-based lawyers – to become the most successful Canadian operator of the last decade, Porter Airlines. This chapter confirms, in a way, that changes to the regulatory landscape can open up business opportunities for local entrepreneurs. In particular, it will demonstrate that senior executives willing to leverage their understanding of the local regulatory environment can achieve sustained competitive advantage in highly contested regional markets. In the case of Porter Airlines, the willingness of its founder, Robert Deluce, to consider a number of nonmarket elements in his initial business plan proved to be a great attitudinal asset. Down the road, the legal astuteness and political cleverness demonstrated by Porter's TMT permitted the signature of an important commercial agreement that guarantees, to this day, Porter's dominant position in Toronto's downtown airport. In sum, it will be contended that the unique, rare, inimitable, and nonsubstitutable relationship developed by a start-up airline with a strategic stakeholder in its immediate nonmarket environment can be a source of sustained competitive advantage. Arguably this has been the case for Porter Airlines despite the aggressive and continuous litigation tactics launched by Air Canada since 2006.

The Role of Legal and Political Astuteness in Corporate Strategy

I. Government Regulation and the Competitive Environment

The sphere of regulatory policy is the most important political battleground where influential interests clash over the necessity for state intervention in the economy. In recent decades, governments have been called upon by various interest groups to mediate consecutive cycles of regulation[4], thus making government intervention a necessary precondition of market competition. In such context, the regulatory state has emerged as the primary political response to the many cataclysms created by successive industrial revolutions[5] and shifts in governance

[4] As demonstrated by different cycles of regulation (early 20th century America), de-regulation (1970-80s in the U.S. and the U.K.), and re-regulation (early 2000s), the state remains instrumental during the processes of formulation and implementation of new economic policies at the national level, and certainly a catalyst and mediator of new economic paradigms at the international level. See especially, Steven K. Vogel, *Freer Markets, More Rules: Regulatory Reform in Advanced Industrial Countries* (Ithaca, NY: Cornell University Press, 1996) [Vogel, *Freer Markets*]. For an excellent account on the economic and social changes brought by the industrial revolution, see especially, Karl Polanyi, *The Great Transformation: The Political and Economic Origins of Our Time*, 2nd ed. (Boston, MA: Beacon Press, 2001). For an excellent comparative account analyzing the modern partnership between the state and global capital, see Yves Tiberghien, *Entrepreneurial States: Reforming Corporate Governance in France, Japan, and Korea,* Cornell Studies in Political Economy (Ithaca, NY: Cornell University Press, 2007).

[5] For a discussion on the factors and social consequences of the so-called information technology revolution, see Jeremy Greenwood, *The Third Industrial Revolution: Technology, Productivity and Income Inequality* (La Vergne, TN: AEI Press, 1997). For a detailed economic assessment of the second industrial revolution, see David S. Landes, *The Unbound Prometheus*, 1st ed. (Cambridge, UK: Cambridge University Press, 1969). For a discussion on the

paradigms[6]. President Obama's rescue package for the financial and automobile industries is the most recent example of the regulatory state in action[7].

State regulation can take different forms depending on the objective sought by the government in place[8]. For example, in a context of economic liberalization, government authorities may introduce **pro-competitive policies** in order to generate competition, either by offering targeted regulatory advantages to competitors or adding new regulations to facilitate the effective operation of markets. In other cases, they may resort to **juridical regulation**, which consists in making regulations more codified and procedures more legalistic as international regulatory standards become more rigorous and unified. In situations where liberalization has failed, governments will tend to engage in **expansionary re-regulation** practices such as extending current regulations into new areas of economic activity. In more extreme cases, governmental authorities may decide to adopt **strategic re-regulation** measures such as providing regulatory advantages to domestic firms or amending existing legislation to subtract advantages granted to foreign firms.

In the airline industry, for example, governmental policies and resulting legislation have the ability to affect the structure of markets by the establishment of entry of economic barriers

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structural and societal changes that the first industrial revolution caused in the Western Hemisphere, see Phyllis Deane, *The First Industrial Revolution*, 1st ed. (Cambridge, UK: Cambridge University Press, 1965).

[6] For a very insightful and authoritative discussion on the subject of paradigm shift, see Thomas S. Kuhn, *The Structure of Scientific Revolutions* (Chicago, IL: University of Chicago Press, 1996).

[7] For two fascinating journalistic-style accounts on Obama's rescue package for the automobile and financial industries, see Steven Rattner, *Overhaul: An Insider's Account of the Obama Administration's Emergency Rescue of the Auto Industry* (Boston, MA & New York, NY: Houghton, Mifflin, Harcourt, 2010); Andrew Ross Sorkin, *Too Big To Fail: The Inside Story of Wall Street and Washington Fought to Save the Financial System – and Themselves* (New York, NY: Group Penguin, Viking, 2009).

[8] Vogel, *Freer Markets, supra* note 4 at 18-20.

such as foreign ownership limits[9] and restrictive allocation of landing slots at major airport hubs[10]. The effectiveness of competition policy can also impact the number of competitors and consumer prices in specific markets. This is particularly the case in predatory pricing situations[11]. Ultimately, governments may, although involuntarily, favour substitute modes of transportation due to the onerous security measures implemented at major international airports[12]. In the past ten years, the airline industry has deployed massive lobbying efforts in all decision-making battlefields (i.e., national governments and agencies, international regulatory bodies, etc.) in order to minimize the economic impact of reactive national security policies and higher airport security taxes[13].

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[9] For an historical comparative overview of ownership limits in the airline industry, see particularly, Yu-Chun Chang, George Williams & Chia-Jui Hsu, "The Evolution of Airline Ownership and Control Provisions" (2004) 10 Journal of Air Transport Management 161. For an argument against foreign ownership limits, see Michael W. Tretheway, "Distortions of Airlines Revenues: Why the Network Airline Business Model Is Broken" (2004) 10 Journal of Air Transport Management 3.

[10] For a legal analysis of airport slots, see Rita Sousa Uva, "The Legal Nature of Airport Slots" (2009) 3 Journal of Airport Management 132. For a financial analysis, see Michael Olbrich, Gerrit Brosel & Marius Hasslinger, "The Valuation of Airport Slots" (2009) 74 Journal of Air Law & Commerce 897. For an economic critique of landing slot allocation policy in the United States, see Daniel R. Polsby, "Airport Pricing of Aircraft Take-Off and Landing Slots: An Economic Critique of Federal Regulatory Policy" (2001) 89 California Law Review 779.

[11] For a case-study analysis on predatory practices, see Paul S. Dempsey, "Predatory Practices & Monopolization in the Airline Industry: A Case Study of Minneapolis/St. Paul" (2001) 29 Transportation Law Journal 129 [Dempsey, "Predatory Pricing"]. For a Canadian perspective, see Andrew Eckert & Douglas S. West, "Predation in the Airline Industry" (2002) 47 Antitrust Bulletin 217 [Eckert & West, "Predation"]. For a critical analysis on how network airlines react to the entry of low-fare airlines in a particular market, see James L. Robenalt, "Predatory Pricing in the Low-Fare Airline Market: Targeted, Discriminatory, and Achieved with Impunity" (2007) 68 Ohio State Law Journal 641 [Robenault, "Predatory Pricing"]. For an analysis on the strategic foundations of predatory pricing, see Kenneth G. Elzinga, "Predatory Pricing and Strategic Theory" (2001) 89 Georgetown Law Journal 2475 [Elzinga, "Predatory Pricing"].

[12] See particularly, Harumi Ito & Darin Lee, "Comparing the September 11 Terrorist Attacks on International Airline Demand" (2005) 12 International Journal on the Economics of Business 225. For an excellent cost-benefit study on security measures implemented after 9/11, see Joseph J. Cordes *et al.,* "Estimating Economic Impacts of Homeland Security Measures" (2006) George Washington Institute of Public Policy (GWIPP), Working Paper #22.

[13] See especially, Garrick Blalock, Kadiyali Vrinda & Daniel H. Simon, "The Impact of 9/11 Airport Security Measures on the Demand for Air Travel" (2005) [unpublished, archived at Cornell University, Department of

In the sports sponsorship industry, government legislation can restrict entry to those domestic markets where firms seeking to build brand equity compete for consumer loyalty[14]. For instance, host governments often enact specific-event legislation in order to protect official corporate sponsors during widely broadcasted sporting events such as the Olympic Games and the FIFA World Cup[15]. Some authors argue that the enactment of ambush marketing legislation, an obligation imposed by international governing bodies to host cities during the bidding process[16], seriously impedes fair competition because it automatically restricts the number of competitors in a particular geographical market[17]. Some authors actually argue that the broad legal protection granted to Olympic symbols, above and beyond the protection already provided by trademark, copyright and fair competition legislation, threatens basic commercial

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Applied Economics and Management]; Bartholomew Elias, *Airport and Aviation Security: U.S. Policy and Strategy in the Age of Globalization* (Boca Raton, FL: Auerback Publications, Taylor & Francis Group, 2010); Robert W. Poole Jr., "Airport Security: Time for a New Model" in Harry Ward Richardson, Peter Gordon & James Elliott Moore, eds., *The Economic Costs and Consequences of Terrorism* (Northampton, MA: Edward Elgar Publishing, 2007).

[14] For an excellent article on the concept of brand equity, see Kevin Lane Keller, "Conceptualizing, Measuring, and Managing Customer-Based Brand Equity" (1993) 57 Journal of Marketing 1.

[15] These are some examples of ambush marketing legislation: *Sydney 2000 Games (Indicia & Images) Protection Act, 1996* (Australia, No. 22, 1996 repealed by *Statute Law Revision Act* No. 8, 2007), *Olympic and Paralympic Marks Act of 2007* (Canada, 2007, c. 25), *London Olympic Games and Paralympic Games Act 2006* (England, 2006, c. 12). For a commentary on the legislative process behind the protection of Olympic marks in the eve of the Vancouver 2010 Winter Olympic Games, see Teresa Scassa, "Faster, Higher, Stronger: The Protection of Olympic Marks Leading Up to Vancouver 2010" (2008) 41 UBC Law Review 31.

[16] See, for example, *IOC Requirements on Brand Protection and Ticket Touting* (Annex 1 – Explanation of the Technical Manuals that accompany the Host City Contract), online at: http.//www.culture.gov.uk/images/freedom_of_information/106119_Annex_A_.pdf (Last accessed: October 4, 2010).

[17] See Tony Meenaghan, "Ambush Marketing – A Threat to Corporate Sponsorship" (1996) 38 MIT Sloan Management Review 103. For a discussion on the effects of ambush marketing on consumer perception, see Adam Portluck & Susan Rose, "Effects of Ambush Marketing: UK Consumer Brand Recall and Attitudes to Official Sponsors and Non-Sponsors Associated with the FIFA World Cup 2006" (2009) 10:4 International Journal of Sports Marketing & Sponsorship. For a discussion on pro-active and pre-emptive measures for sponsors for better combat ambush marketing, see Nicholas Burton & Simon Chadwick, "Ambush Marketing in Sport: An Analysis of Sponsorship Protection Means and Counter-Ambush Measures" (2009) 2 Journal of Sponsorship 303.

freedoms, and especially those of national and local business communities[18]. More recently, local and national advertisers have questioned the economic rationale behind compulsory ambush marketing legislation before the Olympics. In particular, they have pointed out the negative financial impact that such a policy has on competitors and small businesses[19].

Regardless of the policy-orientation favoured by the government in place, regulatory policies may have significant effects on the competitive landscape of firms, shaping the structure and conduct of industries, and ultimately determining the firm's business strategy[20]. Strategic management scholars and international trade economists have attempted to elucidate the effects of economic policy on intra-industry competition[21] as well as the specific responses of firms and trade associations to government regulation[22]. Some have demonstrated, indeed,

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[18] John Grady, Steve McKelvey & Matthew J. Bernthal, "From Beijing 2008 to London 2012: Examining Event-Specific Olympic Legislation vis-a-vis the Rights and Interests of Stakeholders" (2010) 3 Journal of Sponsorship 144 at 149. See also, Grant Dickson, "Protecting Sponsors of Major Events: Getting the Balance Right" (2007) 1 Journal of Sponsorship 189.

[19] Darren Davidson, "Does 2012 Need Anti-Ambush Laws?" *Campaign* (March 3, 2006), online at: http://www.campaignlive.co.uk/news/544580/Close-Up-Live-Issue---Does-2012-need-anti-ambush-laws/?DCMP=ILC-SEARCH (Last accessed: October 4, 2010).

[20] Scott C. Beardsley, Denis Bugrov & Luis Enriquez, "The Role of Regulation in Strategy" (2005) 4 McKinsey Quarterly 92 [Beardsley *et al.*, "The Role of Regulation in Strategy"].

[21] See especially, Michael E. Porter, *Competition in Global Industries* (Boston, MA: Harvard Business School Press, 1986). See also Dani Rodrick, "Political Economy of Trade Policy" in Gene M. Grossman & Kenneth Rogoff, eds., *Handbook of International Economics*, Vol. 3 (New York, NY: Elsevier Science B.V., 1995); Rodney E. Falvey, "Commercial Policy and Intra-Industry Trade" (1981) 11 Journal of International Economics 495.

[22] See particularly, Brian Shaffer, "Firm-Level Responses to Government Regulations: Theoretical and Research Approaches" (1995) 21.3 Journal of Management 495 at 495 [Shaffer, "Firm-Level Response to Government Regulations"]. For an integrated model of various firm responses applied to the U.S. political system, see John M. De Figueiredo & Rui J. De Figueiredo Jr., "The Allocation of Resources by Interest Groups: Lobbying, Litigation, and Administrative Regulation" (2002) 4 Business and Politics 161. For the literature on how to build a successful lobbying strategy, see Aidan R. Vining, Daniel M. Shapiro & Bernhard Borges, "Building the Firm's Political (Lobbying) Strategy" (2005) 5 Journal of Public Affairs 150 [Vining *et al.*, "Lobbying Strategy"]; Amy J. Hillman & Michael A. Hitt, "Corporate Political Strategy Formulation: A Model of Approach, Participation, and Strategy Decisions" (1999) 24:4 Academy of Management Review 825 [Hillman & Hitt, "Corporate Political Strategy

that government policies and resulting legislation directly affect the profitability of regulated and technology-driven industries through their impact on entrants, substitutes, suppliers, and buyers[23]. In response, interested stakeholders have decided to become active in the business of trying to shape their regulatory environment.

Some industries have become particularly skilful in the formulation of political strategies in order to influence policy outcomes, principally inside legislatures, administrative agencies, and courts[24]. Empirical studies actually suggest that high levels of political activity can be found in a number of heavily concentrated, technology-driven, media-based, and regulated industries such as airlines, chemicals, automobiles, agriculture biotechnologies, pharmaceuticals, entertainment and telecommunications[25]. Not surprisingly, "government relations" and "regulatory affairs" units have been gradually incorporated in the strategic structure of firms[26].

Formulation"]. For a conceptual discussion on firms' responses to government regulation, see Murray L. Weidenbaum, "Public Policy: No Longer a Spectator Sport for Business" (1980) 3 Journal of Business Strategy 46.

[23] See particularly, G. Richard Shell, *Make the Rules or Your Rivals Will* (New York, NY: Crown Business & Random House, 2004).

[24] See particularly, Douglas A. Schuler, Kathleen Rehbein & Roxy D. Cramer, "Pursuing Strategic Advantage Through Political Means" (2002) 45 Academy of Management Journal 659; James Snyder, "On Buying Legislatures" (1991) 3 Economics and Politics 93; Donald R. Songer & Reginald S. Sheehan, "Who Wins on Appeal? Upperdogs and Underdogs in the United States Courts of Appeal" (1992) 36 American Journal of Political Science 235. See also, Douglas Schuler, "Corporate Political Strategy and Foreign Competition: The Case of the Steel Industry" (1996) 45 Academy of Management Journal 659 [Schuler, "Corporate Political Strategy"]; John M. De Figueiredo & James J. Kim, "When Do Firms Hire Lobbyists? The Organization of Lobbying at the Federal Communications Commission" 13 Industrial and Corporate Change 883; Emerson H. Tiller, "Controlling Policy by Controlling Process: Judicial Influence on Regulatory Decision-Making" (1998) 14 Journal of Law, Economics, and Organization 114.

[25] See particularly, Kevin B. Grier, Michael C. Munger, & Brian E. Roberts, "The Determinants of Industry Political Activity" (1994) 88 American Political Science Review 911 [Grier *et al.*, "Determinants"]. See also, Daniel C. Esty & Richard E. Caves, "Market Structure and Political Influence: New Data on Political Expenditures, Activity, and Success" (1983) 21 Economic Inquiry 24.

[26] See Robert Grosse, ed., *International Business and Government Relations in the 21st Century* (London, UK: Cambridge University Press, 2005) at Chapter 1.

Academic research in the area of business-government relations has been historically fragmented by disciplinary loyalties, and consequently, has suffered from a lack of theoretical and methodological cohesion. Public choice theorists have defined the political process as a marketplace in which self-interested agents meet in order to maximize their own preferences and personal wealth[27]. Political scientists have examined the historical sources of interest group politics[28], the operation and effectiveness of interest groups, particularly corporations, in shaping public policy[29], as well as the ethical dimensions and moral dilemmas resulting from the interaction between private interests and public institutions[30]. Sociologists have even

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[27] See particularly, James M. Buchanan & Gordon Tullock, *The Calculus of Consent: Logical Foundations of Constitutional Democracy* (Ann Arbor, MI: University of Michigan Press, 1962). See also, Kenneth J. Arrow, *Social Choice and Individual Values*, 2nd ed. (New York, NY: John Wiley & Sons, 1963); Gordon Tullock, *The Economics of Special Privilege and Rent-Seeking* (Boston, MA: Kluwer Academic Publishers, 1989).

[28] See particularly, David B. Truman, *The Governmental Process: Political Interests and Public Opinion*, 2nd ed. (Berkeley, CA: Institute of Governmental Studies, 1993) at Chapters 1-4; Arthur Fisher Bentley, *The Process of Government: A Study of Social Pressures*, 2nd ed. (Piscataway, NJ: Transaction Publishers, 2008 / Originally published in 1908 by the University of Chicago Press). See also, Elisabeth S. Clemens, *The People's Lobby: Organizational Innovation and the Rise of Interest Group Politics in the United States, 1890-1925* (Chicago, IL: The University of Chicago Press, 1997); Daniel J. Tichenor & Richard A. Harris, "The Development of Interest Group Politics in America: Beyond the Conceits of Modern Times" (2005) 8 Annual Review of Political Science 251; Grier *et al.*, "Determinants", *supra* note 25. For an economic perspective, see Oliver E. Williamson, "The Modern Corporation: Origins, Evolution, Attributes" (1981) 19 Journal of Economic Literature 1537.

[29] See especially, Robert A. Dahl, "Business and Politics: A Critical Appraisal of Political Science" (1959) 53 American Political Science Review 1; Edwin M. Epstein, "Business Political Activity: Research Approaches and Analytical Issues" (1980) 2 Research in Corporate Social Performance and Policy 1. See also, James G. March, "The Business Firm as a Political Coalition" (1962) 24 Journal of Politics 662; Edwin M. Epstein, *The Corporation in American Politics* (Upper Saddle River, NJ: Prentice-Hall, 1969); Marie Hojnacki & David C. Kimball, "Organized Interests and the Decision of Whom to Lobby in Congress" (1998) 92 American Political Science Review 775. For a critical analysis from the management field, see Gerald Keim & Barry Baysinger, "The Efficacy of Business Political Activity: Competitive Considerations in a Principal-Agent Context" (1988) 14 Journal of Management 163. For an industry-specific analyses, see John M. De Figueiredo & Emerson H. Tiller, "The Structure and Conduct of Corporate Lobbying: How Firms Lobby the Federal Communications Commission" (2001) 10 Journal of Economics and Management Strategy 91.

[30] See particularly, Vincent R. Johnson, "Regulating Lobbyists: Law, Ethics, and Public Policy" (2006) 16 Cornell Journal of Law and Public Policy 1; Jeffrey H. Birnbaum, *The Lobbyists: How Influence Peddlers Work Their Way in Washington* (New York, NY: Times Books, 1993 / reviewed by Leonard J. Weber, "Citizenship and Democracy:

suggested that corporate behaviour can be explained by the self-identification of a corporation's agents (i.e., executives, senior directors, lawyers, etc.) to a particular social class[31].

In recent years, there has been an organized effort by organizational behaviour, corporate strategy, and law scholars to explain how firms integrate certain legal and political elements into their overall corporate strategy. The consensus, at least from a theoretical perspective, is that legal and political astuteness can positively contribute to the firm's overall performance and competitive advantage. **Part II** of this chapter will review the literature as it relates to the nature and dynamics of the business-government interface, as well as the impact of regulatory activity on business competition. **Part III** will examine the different means – strategic litigation, informational lobbying, and political contributions – used by firms to influence the policy-making process in industrialized democracies. **Part IV** will introduce the literature of the emerging field of law and management. This literature generally contends that firms can achieve competitiveness and improve their overall performance by incorporating various legal systems, processes, and players into their broader corporate strategy.

The Ethics of Corporate Lobbying" (1996) 6 Business Ethics Quarterly 253); J. Brooke Hamilton & David Hoch, "Ethical Standards for Business Lobbying: Some Practical Suggestions" (1997) 7 Business Ethics Quarterly 117.

[31] See particularly, Michael Useem, "Corporations and the Corporate Elite" (1980) 6 Annual Review of Sociology 41. For a Canadian analysis, see Wallace Clement, *The Canadian Corporate Elite: an Analysis of Economic Power* (Toronto, ON: McClelland & Stewart, 1975). For a Quebec analysis, see Pierre Fournier, *The Quebec Establishment: the Ruling Class and the State* (Montreal, QC: Black Rose Books, 1976). For a provocative essay on the role of lawyers in business from a sociological perspective, see Jack Ladinsky, "Careers of Lawyers, Law Practice, and Legal Institutions" (1963) 28 American Sociological Review 47.

II. The Business-Government Interface

A. The Nonmarket Environment Structures the Firm's Competitive Behaviour

Stanford professor David P. Baron was the first to argue that strategy formulation should integrate the market and nonmarket components of the business environment in which firms compete[32]. Openly critical of mainstream theories of competitive analysis, Baron contends that many nonmarket issues arise from market activity. For Baron, the **market environment** includes all interactions between firms and other private parties. These interactions, he observes, are generally voluntary and typically involve economic transactions and proprietary exchanges. They are also primarily intermediated by markets and enforceable private arrangements[33]. In contrast, the **nonmarket environment** comprises all interactions between firms and the government, public institutions, collective and individual stakeholders, and the media. These interactions may be voluntary or involuntary, and are generally governed by principles like due process, the majority rule, collective action, and transparency.[34]. In Baron's own words, "A nonmarket strategy is a concerted pattern of actions taken in the nonmarket environment to create value by improving its overall performance, as in the case in which a firm works through its home government to use trade policy to open a foreign market"[35].

1. The Nonmarket Environment: Definition and Main Elements

Baron defines the nonmarket environment as a set of social, political, and legal arrangements "that structure the firm's interactions outside of, and in conjunction with,

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[32] David P. Baron, "Integrated Strategy: Market and Nonmarket Components" (1995) 37:2 California Management Review 47 [Baron, "Integrated Strategy"].

[33] *Ibid.* at 47.

[34] *Ibid.*

[35] *Ibid.* at 48.

markets"[36]. In his model, the nonmarket environment is characterized by four main elements, namely issues, institutions, interests, and information[37]. First, nonmarket strategies seek to address **issues**. For instance, in the Canadian context, the Competition Bureau's inquiry about Air Canada's illegal advertising of flights out of the Toronto's City Centre Airport (TCCA), a regional airport where the airline has no flight operations, is a nonmarket issue[38]. Second, **institutions** are the administrative or judicial vehicles through which firms address nonmarket issues. In this case, Air Canada would have to address the issue directly with the Competition Bureau, and more particularly its civil affairs branch – the unit responsible for the inquiry – and the legal services department. If the issue is not resolved at the inquiry stage, the next set of relevant institutions would be the Competition Tribunal, the Federal Court and the Federal Court of Appeal of Canada. Third, **interests** include those individuals and groups directly affected by, or with specific preferences in regards to the issue at stake. At this stage, interested parties include Porter Airlines, TCCA's only air carrier operation, Air Canada's regulatory affairs unit, consumer protection groups, air travellers, and the national media. Fourth, **information** relates to what interested parties know or believe about the actions and consequences of a particular issue, and about their own preferences and capabilities. In the case of advertising practices in the airline industry, the quantity and quality of information

[36] *Ibid.*

[37] *Ibid.*

[38] Canada, Competition Bureau, "Air Canada and Jazz Air LP" (17 January 2007) ("The Competition Bureau (Bureau) initiated an inquiry on March 22, 2006, following receipt of a complaint from six persons residing in Canada alleging that Air Canada and Jazz Air LP (collectively, Air Canada) had engaged in anti-competitive conduct with regards to their advertising of flights in and out of the Toronto City Centre Airport contrary to sections 52 (false or misleading representations), 74.01 (misrepresentations to the public) and 79 (abuse of dominant position) of the *Competition Act*."), online at: <http://www.competitionbureau.gc.ca/eic/site/cb-bc.nsf/eng/02246.html> (Last accessed: December 7, 2010).

collected by rivals and consumer protection groups can determine the success of the inquiry led by the Competition Bureau.

2. Nonmarket Strategies: Enabling Factors

According to Baron, several factors may boost the importance of nonmarket issues for the firm's overall business strategy. The first factor is the **control of the firm's market opportunities in relation to government regulation**: "viewing control as a continuum, opportunities can be controlled by government at one extreme and by markets at the other extreme"[39]. Under Baron's theory, nonmarket strategies become particularly important where government regulation occupies a prominent role in the shaping of the competitive landscape: "Generally, nonmarket strategies are more important the more opportunities are controlled by government, and are less important when opportunities are controlled by markets"[40]. **Figure I** below illustrates the relation between the control of market opportunities by government in a regulated environment and the importance of nonmarket strategies for the firm's overall performance[41]. It is clear from this illustration that less regulated industries have, in theory, fewer incentives to engage in nonmarket strategies. Although not directly addressed by Baron, the same industries are likely to face different nonmarket environments depending on the country where they decide to carry their operations. For example, a financial services firm from Hong Kong may not encounter the same issues, institutions and interests when attempting to enter the Canadian market – which is heavily regulated – compared to that of the U.S., which is much less regulated.

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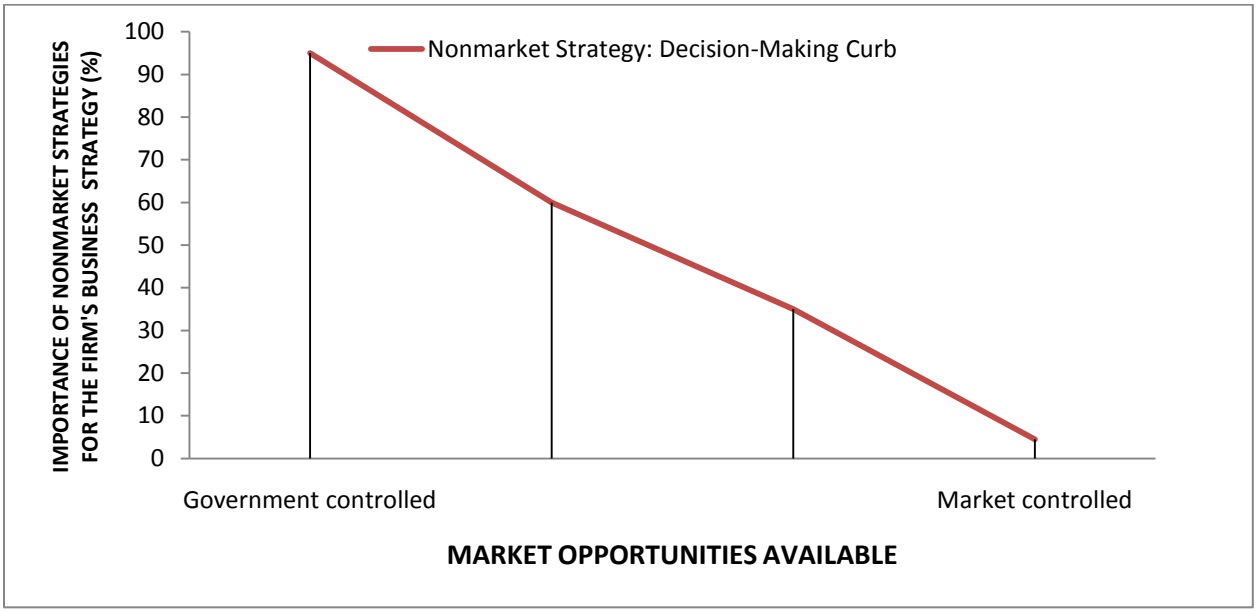
[39] Baron, "Integrated Strategy", *supra* note 32 at 49.

[40] *Ibid.*

[41] Baron presents a similar figure: *ibid.* at 50.

FIGURE I: Nonmarket Strategy and Market Control



The second factor identified by Baron focuses on the **potential public challenges that interest groups and the media can bring**. For example, advocacy groups and consumer groups opposed to intrusive aviation security policies in the U.S. have often used the national media and institutional arenas – regulatory agencies, legislatures, and courts – to challenge alleged violations to constitutional and individual privacy rights[42]. In those situations, the aviation and security industries have had no other choice than to clarify their respective positions. Furthermore, successive public challenges to the agricultural biotechnology industry brought by activists and interest groups have raised consumers' awareness on genetically engineered

[42] Electronic Privacy Information Center, "*EPIC v. DHS (Suspension of Body Scanner Program)*", online at: EPIC: <http://epic.org/privacy/body_scanners/epic_v_dhs_suspension_of_body.html#lawsuit> (Last accessed: December 9, 2010) ("On July 2, 2010, EPIC filed a petition for review and motion for an emergency stay, urging the District of Columbia Court of Appeals to suspend the Transportation Security Administration's (TSA) full body scanner program. EPIC said that the program is "unlawful, invasive, and ineffective." EPIC argued that the federal agency has violated the *Administrative Procedures Act*, the *Privacy Act*, the *Religious Freedom Restoration Act*, and the *Fourth Amendment*. EPIC cited the invasive nature of the devices, the TSA's disregard of public opinion, and the impact on religious freedom").

foods. Firms like Monsanto and DuPont have launched massive public relations campaigns to reassure the public about the health effects of Genetically Modified Organisms (GMOs). Additionally, they have launched expensive strategic litigation and aggressive lobbying strategies in many industrialized countries[43].

3. Nonmarket Strategies: Formulation and Implementation

Baron uses three industry studies to illustrate his integrated "nonmarket strategies" model. The first is about Calgene, Inc., the first agricultural biotechnology firm to initiate a regulatory approval process in order market genetically engineered food in the U.S. The second case is about Cementos Mexicanos (CEMEX), a Mexican firm who is one of the largest cement producers in the world. CEMEX's decision to enter the U.S. market encountered aggressive opposition from U.S. cement producers, who ultimately filed an antidumping petition alleging injury by Mexican cement imports. The third and last case is about retailer Toys 'R' Us and its decision to form joint ventures with foreign entities as part of its globalization strategy. A detailed review of these cases is not necessary for the purposes of this thesis. The conclusions drawn by Baron are nevertheless important. First, developing relationships with regulatory agencies and lobbying the relevant political institutions proved successful in the context of heavily regulated industries (Calgene, Inc.). Second, defensive trade litigation can be an effective strategy to prevent foreign players to enter a domestic market (CEMEX). Third and last, the success of joint venture-based market strategies resides in the firm's capacity to participate in local trade associations to reassure local retailers and consumers while launching massive public relations campaigns (Toys 'R' Us).

[43] For a good account on the political history of biotechnology policy in the European Union and the United States, see especially, Herbert Gottweis, *Governing Molecules: the Discursive Politics of Genetic Engineering in Europe and the United States* (Boston, MA: The MIT Press, 1998).

Baron contends that, at the formulation level, "both market and nonmarket strategies should be considered in addressing and defending against market forces and realizing market alternatives"[44]. In other words, a firm's market strategy must be compatible with its internal capabilities and the characteristics of its market and nonmarket environments. He further observes that while the traditional approach to business strategy formulation has typically focused on industry structure and the distinctive characteristics of firms, many senior managers have reasons to be concerned by the nonmarket environment.

In sum, Baron contends that when "the opportunities of a firm are controlled by government or challenged by public pressure"[45], firms are more likely to implement nonmarket strategies. Interestingly, Baron points to the fact that nonmarket strategies are likely to be more multidomestic than global because the issues, interests, institutions, and information required to formulate them are typically circumscribed by geographical boundaries[46]. Examples of multidomestic nonmarket issues include, among others, the orientation of competition policy in the European Union, the scope of intellectual property protection in the U.S., and the level of enforcement of environmental regulations in Canada. It must be noted, however, that the rise of international governance institutions in the last decade of the twentieth century coupled with the global nature of many policy issues (i.e., climate change, terrorism, etc.) have forced firms to globalize their nonmarket strategies.

B. The Regulatory Environment Affects the Firm's Competitive Landscape

Vining, Shapiro, and Borges (VSB) contend that government regulation directly affects the firm's competitive landscape, and in doing so increases or decreases the firm's overall

[44] Baron, "Integrated Strategy", *supra* note 32 at 58.

[45] *Ibid.* at 63.

[46] *Ibid.* at 64.

performance and profitability[47]. Economists have observed that import restrictions and industry-wide tax expenditures tend to raise the profitability of domestic industries in a given jurisdiction[48]. In other cases, they note, the impact of government policies may be distributional, with some firms within the same industry gaining profits and other firms losing"[49]. Like Baron and De Figuereido, VSB argue that government policies are rarely exogenous and that nonmarket strategies, including corporate political action, can effectively influence the course of government policies. For these reasons, they contend, corporations should not only consider political action as part of their main strategic process, but they should also reconsider whether acting alone or collectively may be the best vehicle to achieve long-term competitive advantage. From a methodological point of view, they suggest that the study of corporate political strategy should be conducted from the firm's perspective.

In sum, VSB contend that governmental actions can shape the competitive landscape in many ways, and not only when the government acts as a supplier or buyer of goods and services[50]. They defend the view that government policies affect rivalry but also profitability through their impact on entrants, substitutes, suppliers, and buyers[51]. In their theoretical model, government policy includes all governmental actions, including those laws and regulations that are likely to affect the performance and the bottom line of corporations such as

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[47] Vining *et al.*, "Lobbying Strategy", *supra* note 22 at 150.

[48] See especially, Gary C. Hufbauer & Kimberley A. Elliott, *Measuring the Costs of Protection in the United States* (Washington, DC: Institute for International Economics, 1994); C. Peter Timmer, *Getting Prices Right* (Ithaca, NY: Cornell University Press, 1986); Gary Mucciaroni, *Reversals of Fortune: Public Policy and Private Interests* (Washington, DC: The Brookings Institution, 1995). Cited in Vining *et al., ibid.* at 152.

[49] See especially, John S. Hughes, Wesley A. Magat & William E. Ricks, "The Economic Consequences of the OSHA Cotton Dust Standards: Analysis of Stock Price Behaviour" (1986) 29 J.L. & Econ. 29. Cited in Vining *et al., ibid.*

[50] See especially, David Besanko, Dabid Dranove & Mark Shanley, *The Economics of Strategy*, 2nd ed. (New York, NY: John Wiley & Sons, 2000). Cited in Vining *et al., ibid.* at 153.

[51] See especially, Sharon M. Oster, *Modern Competitive Analysis* (Oxford, UK: Oxford University Press, 1990). Cited in Vining *et al., ibid.*

taxation, trade, and industrial policies. Borrowing from existing literature in the fields of managerial economics and economic policy, the authors discuss the impact of government policy on each of the "five market forces" identified by Michael Porter's in his famous analysis of competitive strategy[52]. **Figure II** below illustrates VSB's competition model in which the state acts as an independent force through government policy. It also summarizes **Section 1** ("Rivalry among Existing Firms"), **Section 2** ("Threats of New Entry and Substitutes Products and Services"), and **Section 3** ("Bargaining Power of Buyers and Suppliers").

1. Rivalry among Existing Firms

Governmental action can threaten profits for all incumbent firms in the industry through industry-specific tax policy. For instance, industry-specific taxation is common in extractive industries (mines, oil & gas, forestry) and those industries involved in the processing of natural resources (aluminum)[53]. The implementation of these policies can either take the form of output taxes or compulsory bidding processes for access to the resources[54]. Government policies can also affect the firm's revenues when they distribute money through subsidies, tax credits, or even when they set pricing floors.

According to VSB, the major policy sources that impact rivalry are "industry-specific regulation, industry-specific tax and industrial policy, trade policy, industry-specific ownership policies, and competition/anti-trust policy"[55]. Environmental, health and safety regulations are normally described as "cost-rising measures" by the targeted industries and

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[52] Michael E. Porter, *Competitive Strategy* (New York, NY: The Free Press, 1985) [Porter, *Competitive Strategy*].

[53] See Robert F. Conrad & R. Bryce Hool, *Taxation of Mineral Resources* (Lexington, MA: D.C. Heath and Co., 1980). See also, John McMillan, "Selling Spectrum Rights" (1994) 8 J. of Econ. Perspectives 145.

[54] Vining *et al.*, "Lobbying Strategy", *supra* note 22 at 154.

[55] *Ibid.*

firms[56]. In some industries like pharmaceuticals, a regulatory change may alter the competitiveness of low-cost incumbents by allowing them to comply with regulations at a lower unit cost or more quickly[57]. In certain cases, the largest firms may also be the big winners of governmental policies when these reward high levels of research productivity[58].

The authors also observe that national industrial policies are frequently implemented through specific taxation policies, thus making tax expenditures less visible for the general public[59]. Tax benefits to strategic industries can sometimes be firm specific, especially when the national interest or domestic jobs are at stake. In many cases, these tax benefits account for the bulk of governmental efforts to promote business activity. Finally, it must be noted that the application of competition policy can benefit more some firms or market segments within a specific industry – compared to the industry as a whole. In some cases, the effective application of competition legislation will positively affect incumbent firms because it protects them from powerful, well-established rivals[60].

2. Threats of New Entry and Substitute Products or Services

Governments have historically applied entry restrictions in a number of network industries such as telecommunications, electricity and transportation. Barriers to trade and investment

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[56] See especially, Robert W. Hahn & John A. Hird, "The Costs and Benefits of Regulation: Review and Synthesis" (1991) 8 Yale Journal of Regulation 233; Thomas D. Hopkins, *Regulatory Costs in Profile*, Policy Study #132 (St. Louis, MO: Center for the Study of American Business, 1996). Cited in Vining *et al.*, *ibid.* at 155.

[57] See David L. Weimer, "Organizational Incentives: Safe and Available Drugs" in Leroy Graymer & Fred Thompson, eds., *Reforming Social Regulation* (Beverley Hills, CA: Sage Publications, 1982) at 19-69. Cited in Vining *et al.*, *ibid.*

[58] See Lacy G. Thomas, "Regulation and Firm Size: FDA Impacts on Innovation" (1990) 21 RAND Journal of Economics 497. Cited in Vining *et al.*, *ibid.*

[59] Vining *et al.*, *ibid.* ("Examples include direct subsidies to corporations as well as tax credits, tax exemptions, investment credits and depreciation write-offs").

[60] See especially, B. Espen Eckbo & Peggy Weir, "Antimerger Policy Under the *Hart-Scott-Rodino Act*: A Reexamination of the Market Power Hypothesis" (1985) 28 J.L. & Econ. 119. Cited in Vining *et al.*, *ibid.* at 156.

can also prevent incumbent firms to enter a specific market. For example, limits on foreign ownership of national airlines are a well-known tool that governments use to preserve the so-called national interest. According to Cansier and Krumm, environmental regulations can also restrict entry by requiring operating permits to incumbent or foreign firms, and thus indirectly providing subsidies to domestic firms[61].

Henderson and Clark observe that, sometimes, substitute products can be great threats to firms, even compared to conventional new entrants[62]. For example, governments may alter the competitive balance of an industry by introducing research and development incentives for certain substitute technologies[63]. Christensen explains that sustained government support of a substitute technology can even lead to the dissolution of an existing industry[64]. For instance, government support for laser technologies in the early 80s is considered by many commentators as a key factor that ultimately displaced vinyl records and tapes in the recording industry.

Furthermore, government subsidies to large firms in mature industries can also prevent substitute firms to become competitive. In certain heavily regulated industries, substitution can be limited by legislation[65]. In some other cases, tariffs imposed on foreign substitutes can even

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[61] See especially, Dieter Cansier & Raimund Krumm, "Air Pollution Taxation: An Empirical Survey" (1997) 23 Ecological Economics 59. Cited in Vining *et al.*, *ibid.*

[62] See especially, Rebecca M. Henderson & Kim B. Clark, "Architectural Innovation: The Reconfiguration of Existing Product Technologies and the Failure of Established Firms" (1990) 35 Admin. Science Quarterly 9.

[63] See Steve T. Walsh & Bruce A. Kirchhoff, "Technology Transfer from Government Labs to Entrepreneurs" (2002) 10 Journal of Enterprising Culture 133. Cited in Vining *et al.*, "Lobbying Strategy", *supra* note 22 at 157.

[64] See especially, Clayton M. Christensen, *The Innovator's Dilemma: When New Technologies Cause Great Firms to Fail* (Boston, MA: Harvard Business School Press, 1997).

[65] See especially, George J. Benston, "Universal Banking" (1994) 8 J. of Econ. Perspectives 121. See also, Anthony Saunders & Ingo Walter, *Universal Banking in the United States: What Could We Gain? What Could We Lose?* (New York, NY: Oxford University Press, 1994). Cited in Vining *et al.*, "Lobbying Strategy", *supra* note 22 at 157.

benefit domestic dinosaurs[66]. The emergence of new technologies can also be prevented by outdated health, safety and environmental policies. National patent policies have also the power to affect the competitive landscape through the imposition of compulsory licensing regulations for pharmaceutical drugs, thus allowing the entry of generic substitutes[67].

3. Bargaining Power of Buyers and Suppliers

The effect of government intervention on suppliers is often felt at the level of primary resources and raw materials suppliers. As discussed above, rent taxation policy and tariff policies may directly affect the profitability of these industries. Some authors have also observed that educational policies directly affect the quantity, quality, and price of human capital, which consequently influences industry-wide productivity[68].

Among those government policies that have proved beneficial to buyers are "consumer legislation, including product disclosure requirements, cooling-off periods, advertising regulations, product testing for safety and health effects, and price controls"[69]. It must be noted that these policies can either lower the short-term profitability of firms or open up the doors for new entrants.

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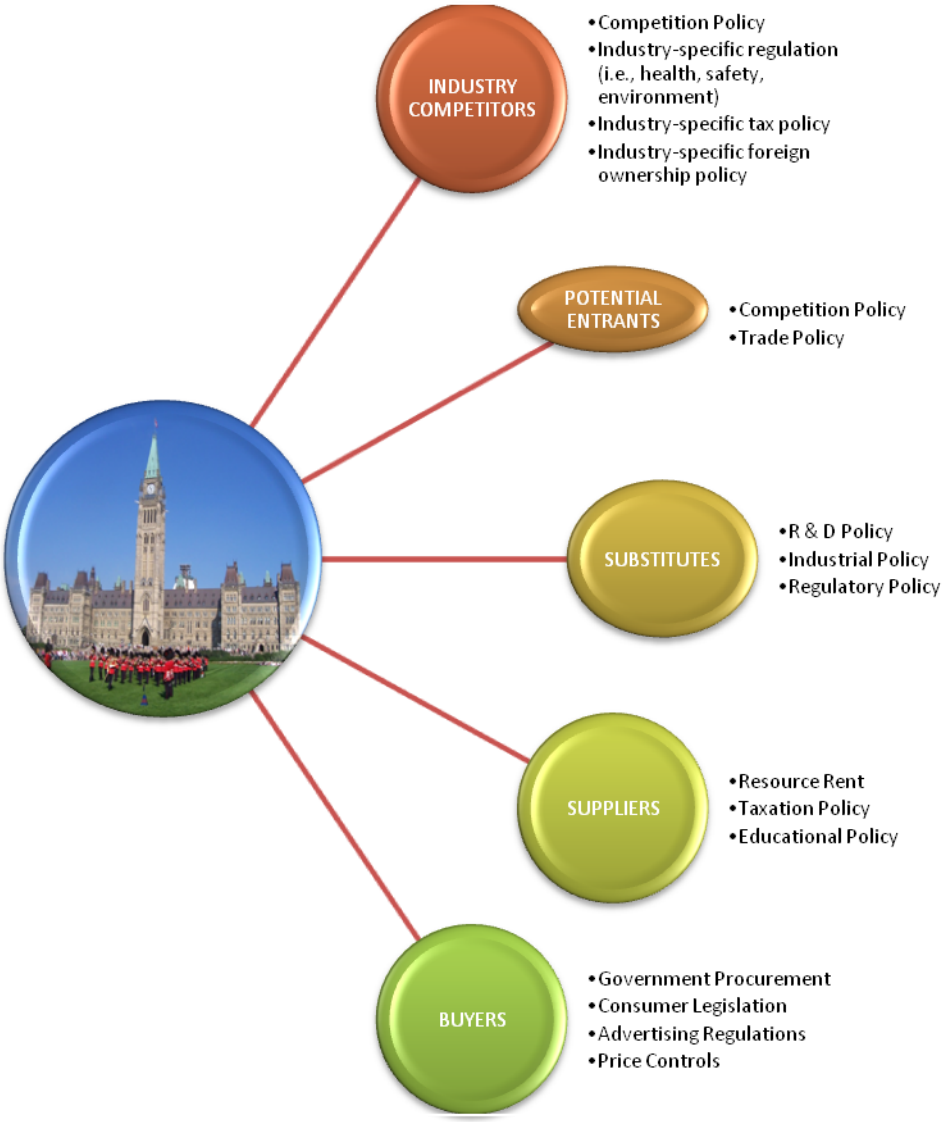
[66] See especially, Anne O. Krueger, "The Political Economy of Controls: American Sugar" in Lee J. Alston, Thraínn Eggertsson & Douglass C. North, eds., *Empirical Studies in Institutional Change* (New York, NY: Cambridge University Press, 1996). Cited in Vining *et al.*, *ibid.*

[67] See especially, Daniel M. Shapiro & Lorne N. Switzer, "The Stock Market Response to Changing Drug Patent Legislation: The Case of Compulsory Licensing in Canada" 14 Managerial and Decision Economics 247. Cited in Vining *et al.*, *ibid.*

[68] See especially, Sandra E. Black & Lisa M. Lynch, "Human Capital Investments and Productivity" (1996) 86 American Economic Review: Papers and Proceedings 263. Cited in Vining *et al.*, *ibid.* at 158.

[69] Vining *et al.*, *ibid.*

Figure II: How Government Policy Affects the Competitive Landscape



C. The Legal Sphere is a Source of Threats and Opportunities for Firms

Roquilly proposes a theoretical framework model based on the concept of legal sphere. In this model, corporations assess the threats and opportunities arising from those "decisions

made outside the firm but within its regulatory environment"[70]. According to Roquilly, these external considerations must be identifiable and anticipated. They also require "a response or an internal decision in line with [the] strategic objectives [of the firm]"[71]. Interestingly, Roquilly admits that the firm's responses to external threats and opportunities emerge within the firm. At the organizational level, internal departments are presumably expected to monitor the legal sphere with the aim to ensure that the firm remains competitive through changing conditions. At the individual level, senior managers will coordinate the formulation and implementation of appropriate responses. As will be discussed in Chapter 3, Roquilly's theoretical model is in line with the resource-based view of the firm proposed by Jay Barney in his landmark article "Firms Resources and Sustained Competitive Advantage"[72].

1. The Legal Sphere: Regulatory and Competitive Environments

Regarding the actual composition of the legal sphere, Roquilly notes that the firm's **regulatory environment** is often industry-specific and carries a number of obligations based on legislative instruments. The **competitive environment** embodies all the legal decisions adopted by the firm's competitors that may potentially affect its performance and profitability. It must be noted that his model is compatible with the legal astuteness approach proposed by Bagley[73]

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[70] Christophe Roquilly, "From Legal Monitoring to Legal Core Competency: How to Integrate the Legal Dimension into Strategic Management" in Antoine Masson & Mary J. Shariff, eds., *Legal Strategies: How Corporations Use Law to Improve Performance* (Berlin: Springer, 2010) at 9 [Roquilly, "Legal Core Competency"].

[71] *Ibid.*

[72] Jay B. Barney, "Firm Resources and Sustained Competitive Advantage" (1991) 17:1 Journal of Management 99 [Barney, "Firm Resources"].

[73] Constance E. Bagley, "Winning Legally: The Value of Legal Astuteness" (2008) 33:2 Academy of Management Review 378 at 378 [Bagley, "Legal Astuteness"].

and the strategic-proactive model analyzed by Masson and Shariff[74]. Like Baron[75], he considers that the regulatory environment of a corporation is a source of threats and opportunities that must be detected and contained if necessary. Roquilly pays particular attention to those legal initiatives adopted by competitors that "may adversely affect or threaten a firm's strategic objectives"[76]. For example, he points to intellectual property portfolios[77], methods of defence against hostile takeovers[78], and the use of exclusive or selective distribution contracts[79].

Figure III below illustrates the variety of responses that firms can adopt to respond to the threats and opportunities emerging from Roquilly's legal sphere. It is important to note that, in practice, the legal sphere is far from being a homogenous structure. Its composition and dynamics may vary from one country, state, province, and even from one municipality to another.

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[74] Antoine Masson & Mary J. Shariff, *Legal Strategies: How Corporations Use Law to Improve Performance* (Berlin: Springer, 2010) [Masson & Shariff, "Legal Strategies"].

[75] Baron, "Integrated Strategy", *supra* note 32.

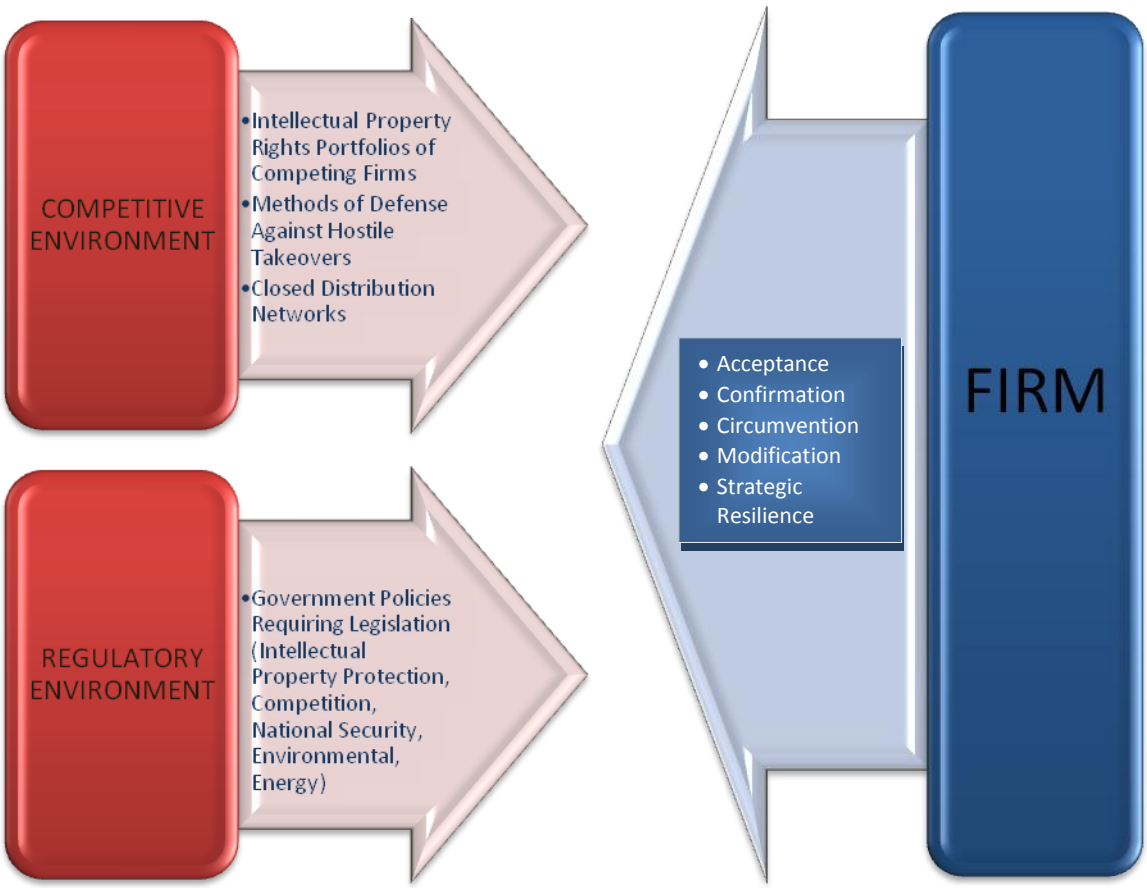
[76] Roquilly, "Legal Core Competency", *supra* note 70 at 10.

[77] See particularly, James Gibson, "Risk Aversion and Rights Accreditation in Intellectual Property Law" (2007) 116:5 Yale L.J. 882; Rudi Bekkers, Geert Duysters & Bart Verspagen, "Intellectual Property Rights, Strategic Technology Agreements, and Market Structure: The Case of GSM" (2002) 31:7 Research Policy 1141.

[78] See particularly, John Armour & David A. Skeel Jr., "Who Writes the Rules for Hostile Takeovers and Why? The Peculiar Divergence of U.S. and U.K. Takeover Regulation" (2007) 95 Geo L.J. 1727. See also Sharon Hannes, "A Demand-Side Theory of Antitakeover Defenses" (2006) 35:2 J. Legal Stud. 475; Lucian A. Bebchuk, John C. Coates IV & Guhan Subramanian, "The Powerful Antitakeover Force of Staggered Boards: Theory, Evidence and Policy" (2002) 54:5 Stanford L.R. 885; Jeffrey N. Gordon, "What Enron Means for the Management and Control of the Modern Business Corporation: Some Initial Reflection" (2002) 69:3 U. Chicago L. Rev. 1233.

[79] See particularly, Thomas Buettner *et al.*, "An Economic Analysis of the Use of Selective Distribution by Luxury Goods Suppliers" (2009) 5:1 Eur. Comp. J. 201; Andrew I. Gavil, "Exclusionary Distribution Strategies by Dominant Firms: Striking a Better Balance" (2004) 72 Antitrust L.J. 3; Christophe Collard & Christophe Roquilly, "Closed Distribution Network and E-Commerce: Antitrust Issues" (2002) 16:1 Int'l Rev. of Law Computers and Tech. 81; Frederic M. Scherer, "Retail Distribution Channel Barriers to International Trade" (1999) 66:1 Antitrust L.J. 77.

Figure III: Firm Responses to Threats and Opportunities Emerging in the Legal Sphere



Under Roquilly's model, regulatory pressures typically place limits on diversity while restricting the number of available opportunities for firms. This view echoes Baron's integrated model where market opportunities available to firms vary depending on the level of government control over a specific industry sector. According to Roquilly, legal risks arise whenever there is "vagueness or instability of legislative or regulatory texts, or case law"[80]. Since these risks must be detected as soon as possible, legal monitoring is an important preventive tool for those corporations seeking to ascertain and adapt to the evolving legal

[80] Roquilly, "Legal Core Competency", *supra* note 70 at 10.

sphere[81]. Legal monitoring also impacts the firm's ability to react in a timely and effective manner[82]. For instance, the amendment of corporate charters and take-over statutes can be determinative of a firm's decision to open its headquarters in a specific jurisdiction[83]. Further, the adoption of special legislation to protect Olympic marks may negatively affect the marketing strategy – and subsequently total sales – of local retailers during the celebration of the Olympic Games.

Roquilly also contends that legal risks can be sources of opportunities. For example, bankruptcy regulations may create certain incentives for entrepreneurs[84] and stringent corporate governance rules may increase the demand for services such as auditing[85]. In other words, new developments in the legal sphere can offer new business opportunities for legally astute firms. In the airline industry, the modification of minimum crew requirements per number of passenger from a 1/40 ratio to a 1/50 ratio has allowed airlines to develop new niche segments in regional markets without increasing labour costs. It is clear from these examples that regulatory management is an essential strategic tool requiring "extensive knowledge of the potential impact of different elements within the legal sphere"[86]. Roquilly

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[81] Laurence Capron & Olivier Chatain, "Acting on Competitors' Resources through Interventions in Factor Markets and Political Markets" (2008) 33:1 Academy of Management Review 97.

[82] James B. Thomas, Shawn M. Clark & Dennis A. Gioia, "Strategic Sense Making and Organizational Performance: Linkages Among Scanning, Interpretation Action, and Outcomes" (1993) 36:2 Academy of Management Journal 239.

[83] See particularly, Roberta Romano, "Competition for Corporate Charters and the Lesson of Take-Over Statutes" (1993) 61 Fordham L. Rev. 843; Marcel Kahan, "The Demand for Corporate Law: Statutory Flexibility, Judicial Quality, or Takeover Protection" (2006) 22:2 J. of Law, Economics, and Organization 340.

[84] Seung-Hyun Lee, Mike W. Peng & Jay B. Barney, "Bankruptcy Law and Entrepreneurship Development: A Real Option Perspective" (2007) 32:1 Academy of Management Review 257.

[85] See particularly, Stephen Maijoor & Arjen Van Witteloostuijn, "An Empirical Test of the Resource-Based Theory: Strategic Regulation in the Dutch Audit Industry" (1996) 17:7 Strategic Management Journal 549.

[86] For an excellent article on the role of regulation in the strategy formulation of multi-national companies, see Beardsley *et al.*, "The Role of Regulation in Strategy", *supra* note 20.

does not provide, however, any indication as to which type of firms or industries are more likely to develop internal capacities to deal with risks emerging from the legal sphere. Some authors have suggested that the performance of multinational firms is heavily influenced by their capacity to identify external risks[87]. Roquilly does not elaborate either on the issue of whether corporate coalitions or strategic alliances could be complementary vehicles to manage legal risks and reduce the associated costs with developing internal monitoring capacities.

2. Firm-Level Responses to Legal Risks and Opportunities

Roquilly provides, however, a useful classification of possible reactions to threats and opportunities emerging from the legal sphere. For example, when reacting to threats, corporations may **accept the constraints and refuse to take legal risks**. The best illustration of this response can be found in the establishment of best practices or compliance programs to improve the firm's corporate governance structure[88]. According to Baucus, firms have significant financial incentives to act legally at all times[89]. The most important measure supporting this assertion is the ratio of assets on returns of compliant firms in comparison with their non-compliant competitors.

Alternatively, firms may decide to adopt a **confrontational approach** where the new law or regulations are perceived as illegitimate or over-intrusive. Senior managers may also decide to act confrontationally when the proposed law or regulation carries too many constraints that

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[87] See especially, Witold J. Henisz & Bennet A. Zelner, "The Strategic Organization of Political Risks and Opportunities" (2003) 1:4 Strategic Organization 451.

[88] See particularly, Chi-Kun Ho, "Corporate Governance and Corporate Competitiveness: An International Analysis" (2005) 13:2 Corporate Governance: An International Review 211. Cited in Roquilly, "Legal Core Competency", *supra* note 70 at 13.

[89] See Melissa S. Baucus & David A. Baucus, "Paying the Piper: An Empirical Examination of Longer-Term Financial Consequences of Illegal Corporate Behaviour" (1997) 40:1 Academy of Management Journal 129. Cited in Roquilly, "Legal Core Competency", *supra* note 70 at 14.

affect their core business[90]. The confrontational approach includes court challenges and public campaigns to gain popular support. The third possible reaction is **circumvention**, namely a strategy based on the search of alternative solutions within the legal sphere, but without transgressing the law. According to Roquilly, "circumvention is concerned with seeking out opportunity, but image-related risks remain a factor of consideration"[91]. For example, the adoption of hiring practices based on the avoidance of a labour practices regulation or an aggressive anti-union stand may have negative repercussions in terms of public opinion[92]. A fourth possible alternative is the **modification of external constraints** "with the aim of either reducing the level of risk or threat or transforming the risk into an opportunity"[93]. Launching an alternative business model to challenge a competitor's dominant position or diversifying a corporation's commercial activities are two obvious illustrations.

The last possible alternative identified by Roquilly is **strategic resilience**. For example, firms may decide to accept the enormous legal risks posed by an external regulatory reality (i.e., lack of enforcement of intellectual property rights) or a competitive trend (i.e., moving manufacturing plants to markets with inexpensive labour force) by entering into joint venture agreements. For instance, a French firm (Michelin) may decide to enter into a joint venture agreement with a Chinese State-owned Enterprise (SOE) in order to minimize the poor levels of

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[90] Roquilly, *ibid.*

[91] *Ibid.*

[92] See particularly, Stephen J. Frenkel & Duncan Scott, "Compliance, Collaboration and Codes of Labor Practice" (2002) 45:1 California Management Review 1. In the province of Quebec (Canada), Walmart has consistently received bad press following its anti-union stand. See particularly, "Wal-mart: Les petits prix ou les travailleurs?" *Radio-Canada: Maisonneuve en Direct* (14 octobre 2004), online: Radio-Canada <http://www.radio-canada.ca/radio/maisonneuve/14102004/40824.shtml> (Last visited: November 19, 2010) See also, Daphné Cameron, "La fermeture du Wal-Mart de Jonquière est légale" *La Presse* (29 novembre 2009), online: La Presse <http://lapresseaffaires.cyberpresse.ca/economie/commerce-de-detail/200911/27/01-925723-la-fermeture-du-wal-mart-de-jonquiere-est-legale.php> (Last visited: November 19, 2010).

[93] Roquilly, "Legal Core Competency", *supra* note 70 at 15.

legal security and reliability associated with entering the local market[94]. It is worth mentioning that joint venture structures can provide participating firms with new and powerful sources of competitive advantage[95] and they can also become important sources of distinctive competencies[96]. As put by Powell, "firms pursue cooperative agreements in order to gain fast access to new technologies or new markets, to benefit from economies of scale in joint research and/or production, to tap into sources of know-how located outside the boundaries of the firm, and to share the risks for activities that are beyond the scope of capabilities of a single organization"[97]. In light of this, it is safe to conclude that strategic resilience, and thus joint venture arrangements may emerge in situations where the firm's legal monitoring capabilities or legal resources are not sufficient to cope with the instability, uncertainty, or the costs associated with imminent legal risks.

Roquilly contends that "only highly successful legal monitoring will allow a firm to provoke legal opportunity within the legal sphere"[98]. In tune with the integrated theory proposed by Baron and the legal astuteness movement led by Bagley, Roquilly believes that "management and legal experts with a superior understanding of the power structures behind the

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[94] *Ibid.* ("In 2001 Michelin signed a cooperation agreement with a Chinese company resulting in the creation of Shanghai Michelin Warrior Tire Co. Ltd. Michelin took this strategic risk despite the fact that the legal environment in China offers little security in terms of intellectual property rights and is known to have a judiciary with poor reliability.")

[95] Kathryn R. Harrigan, "Strategic Alliances and Partner Asymmetries in International Business" in Farok J. Contractor & Peter Lorange, eds., *Cooperative Strategies in International Business* (Lexington, MA: Lexington Books, 1988) at 205-26.

[96] See especially, Rosabeth M. Kanter, *When Giants Learn to Dance* (New York, NY: Simon & Schuster, 1989). See also, Walter W. Powell, "Neither Market Nor Hierarchy: Network Forms of Organization" in Barry M. Staw & Larry L. Cummings, eds., *Research in Organizational Behaviour*, vol. 12 (Greenwich, CT: JAI Press, 1990) at 295-336.

[97] *Ibid.* at 315.

[98] Roquilly, "Legal Core Competency", *supra* note 70 at 15.

development of legislation have the capacity to improve the welfare of firm shareholders"[99]. **Section III** of this chapter will provide an overview of the theories and approaches regarding corporate political action.

III. Approaches to Political Astuteness

Brian Shaffer explores the business-government interface from the viewpoint of the corporation and the manager, and discusses the consequences of public policies for the competitive environment in which corporations evolve. He notes that senior managers increasingly perceive governmental affairs as a "defence against regulatory intrusions and as a means of gaining corporate advantage"[100]. He also points out to the fact that corporations generally articulate their political interests though "environmental scanning, lobbying, political action committees (PACs), coalition building (including trade associations), and advocacy advertising"[101]. In short, he argues that corporate responses to the regulatory environment should include both strategic adaptation and attempts to influence public policy. His analytical framework is very useful when for assessing "the competitive effects of public policies and for predicting the responses of firms to legislative and regulatory issues"[102].

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[99] *Ibid.* at 16. See Bagley, "Legal Astuteness", *supra* note 73. See also, Hillman & Hitt, "Corporate Political Strategy Formulation", *supra* note 22.

[100] Shaffer, "Firm-Level Response to Government Regulations", *supra* note 22 at 495; Harold Stieglitz, "Chief Executives View their Jobs: Today and Tomorrow" in U.S. Conference Board Report #871 (New York, NY: The Conference Board, 1985) at 14.

[101] Shaffer, *Ibid.*

[102] *Ibid.* at 497.

A. Influencing the Policy-Making Process: Strategic Litigation and Lobbying Influence

Stanford professor John M. De Figuereido proposes an integrated theory of corporate political strategy. He starts from the premise that the regulatory environment – namely all laws, rules, and regulations established by public authorities – impacts the competitive landscape[103]. In a way, his argument echoes that of Shaffer's when it recognizes that "legal and acceptable competitive behaviour is determined endogenously by legislators, regulators and judges who are influenced, positively and negatively, by the very same firms the regulations are designed to control"[104]. Professor De Figuereido posits that governments and firms interact in a circular, reinforcing, and oftentimes antagonistic fashion. More specifically, he contends that corporations can pursue profits by "winning the nonmarket competition in the political arena so that political actors create rules which [would ultimately] enhance the profitability of the firm, either directly or indirectly[105]. Furthermore, he notes that corporations have usually two instruments at their disposal to influence policy-making, **money** and **information**[106].

Professor De Figueiredo agrees with Vining, Shapiro, and Borges (VSB) in that government policy shapes – through subsidies, tax breaks, and antitrust policy, among others – the competitive arena. However, he overlooks the fact that competitors continually implement legal strategies that can be detrimental to other industry players. As noted by Roquilly, "intellectual property rights in the portfolios of competing firms, methods of defence against hostile

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[103] John M. De Figueiredo, "Integrated Political Strategy" (2009) NBER Working Paper #15053 at 1 ("Indeed, in many ways, these rules *are* the competitive landscape on which firms compete.") [De Figueiredo, "Integrated Political Strategy"].

[104] *Ibid.* at 2.

[105] *Ibid.* at 4.

[106] *Ibid.* at 4. See also, James Snyder, "Campaign Contributions as Investments: The U.S. House of Representatives, 1980-1986" (1990) 98 Journal of Political Economy 1195; James Snyder, "Long-Term Investing in Politicians; Or Give Early, Give Often" (1992) 35 Journal of Law & Economics 15.

takeovers, and closed distributions networks using exclusive or selective distribution contracts all constitute legal factors that may adversely affect or threaten a firm's strategic objectives"[107]. In the airline industry, for example, international air carriers regularly enter into carefully crafted exclusivity agreements with other airlines[108]. This precludes smaller air carriers from competing for important international feed traffic. In the sports marketing industry, the International Olympic Committee (IOC) routinely forces organizing countries to adopt special legislation intended to provide above-average trademark protection to official sponsors, thus disregarding the commercial rights of local retailers and other non-sponsors to the event.

Like in Baron's model, the integrated theory proposed by De Figueiredo assumes that the competitive landscape for pricing, investment, and competition decisions is endogenous[109]. He actually contends that this landscape can be "created, tilted, or altered"[110] by politically astute firms. In other words, he suggests that firms have the ability to change the competitive landscape to their advantage through constant interactions with political institutions. Strategic litigation, informational lobbying and political contributions are the three most important political strategies identified by De Figueiredo. He also takes into account the three most important levels of policy-making in democratic societies, namely legislatures, agencies, and

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[107] Roquilly, "Legal Core Competency", *supra* note 70 at 10.

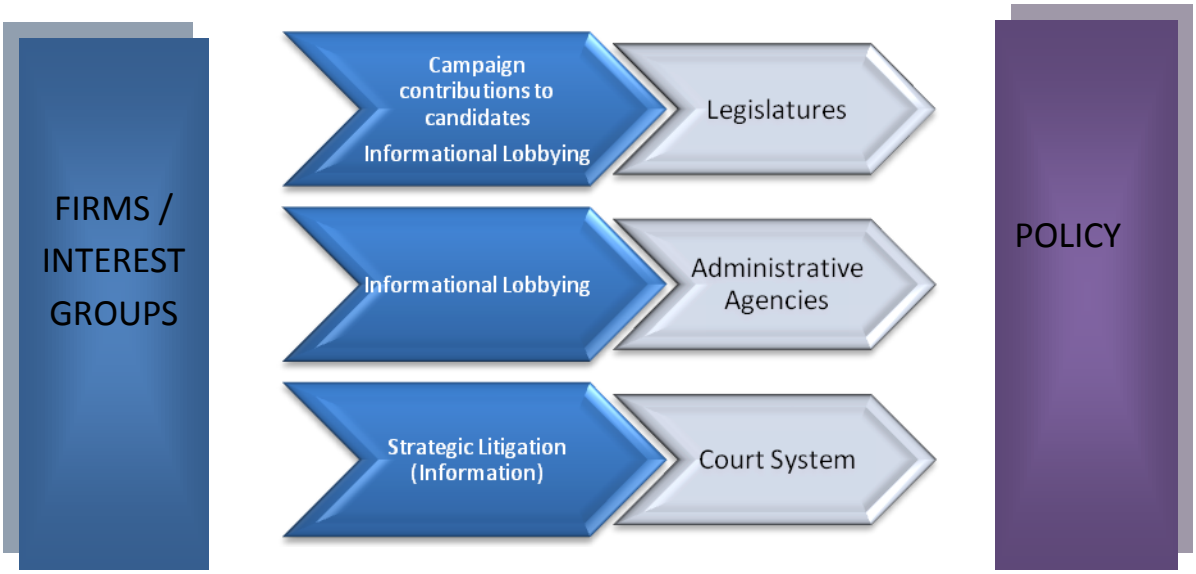
[108] For an elaborate discussion on strategic alliances in the airline industry, see especially, Paul S. Dempsey, *Airline Management Strategies for the 21st Century*, 2nd ed. (Chandler, AZ: Coast Aire Publications, 2006) at 619 (Chapter 13 – Alliances) [Dempsey, *Airline Management Strategies*].

[109] It must be noted that mainstream theories of strategic management consider the regulatory environment established by government an exogenous element (See Michael E. Porter & Claas van der Linde, "Green and Competitive" (1995) 73:5 Harvard Business Review 120). De Figueiredo, "Integrated Political Strategy", *supra* note 103 at 0 ("Whether industry-driven, resource-based, technology-focused or network-centric, the tools and theories of strategic management focus on how firms gain competitive advantage over their rivals when the landscape is exogenously given.")

[110] *Ibid.* at 0.

courts. **Figure IV** below summarizes professor's De Figueiredo's integrated model of corporate political action.

Figure IV: Integrated Model of Corporate Political Action



1. *Legislatures and Informational Lobbying*

Professor De Figueiredo contends that legislatures can affect economic activity through their ability to tax corporations and use that money for social program transfers and government procurement. However, he argues, the most powerful mechanism by which legislatures may affect the competitive landscape is through the regulation of certain economic activities. Government regulation, he observes, may include general regimes – such as competition/antitrust policy, intellectual property laws, advertising and consumer protection regulations – but may also consist of industry-specific legislation in the areas of civil aviation, biotechnologies, telecommunications, energy, and banking. Campaign contributions[111] are

[111] Also known as Political Action Committees (PAC).

perhaps the most controversial tool that corporations have at their disposal to influence the policy-making process in legislatures. However, it has yet to be empirically proved that monies legally transferred to legislators directly influence policy outcomes[112]. The prevalent view in the literature is that money buys access to staff and to House Representatives in the U.S. or Members of Parliament (MPs) in Canada[113]. Once access is obtained, firms are free to engage in a variety of lobbying practices, from multi-stakeholder meetings to private communications[114].

Four theoretical models on informational lobbying are identified by De Figueiredo. The **canonical model** entails a principal-agent relationship in which the lobbyist (agent) has more or better information on the effects of a policy than the legislator (principal). For example, the lobbyist may have empirical or scientific information about the impact of a certain policy. In the **asymmetric information model**, the lobbyist may also be capable to obtain statistical data about the preferences of constituents, or some technical information relevant to the implementation of the proposed policy. The information received can be either verified ex post by the principal or not verified at all"[115]. The third model is called **counteractive lobbying model.** It consists of two industry groups or several competitors investing in data collection, and then deciding when and which legislators to lobby. When information is not verifiable or

[112] De Figueiredo, "Integrated Political Strategy", *supra* note 103 at 5-6 ("Empirical work on vote buying is mixed. […] The prevalent empirical view until about five years ago was that money transfers significantly influenced vote outcomes… [However,] the increasingly prevalent view amongst academics is that campaign contributions do not buy votes (at least in the United States).")

[113] David Austen-Smith "Campaign Contributions and Access" (1995) 89 American Journal of Political Science 566; John M. Hansen, *Gaining Access: Congress and the Farm Lobby, 1919-1981* (Chicago, IL: University of Chicago Press, 1991). Cited in De Figueiredo, "Integrated Political Strategy", *supra* note 103 at 6.

[114] De Figueiredo, *ibid.* at 7.

[115] *Ibid.*

simply based on ideological biases, corporations will opt for the "cheap talk" or **hot air model**. The acquisition and transmission of information under this model is relatively inexpensive[116].

2. Administrative Agencies

De Figuereido notes, however, that legislatures frequently lack the expertise and time to implement the laws they approve. Consequently, they tend to delegate the administration of adopted legislation, including rule-making and adjudicative powers in some cases, to administrative agencies. He is of the view that "the ability of agencies to engage in rulemaking and adjudication makes agencies perhaps the most intrusive, if not important, governmental player in the day-to-day operations of firms"[117]. He then cites a few concrete cases from the U.S. regulatory environment. For example, telecommunications giant Verizon is prohibited to enter certain markets unless it receives prior permission from the Federal Communications Commission (FCC)[118]. As well, Pacific Gas and Electric (PG&E) needs permission from the Environmental Protection Agency (EPA) before building new plants[119]. Most authors agree to the effect that agencies, including bureaucracies, are more expert, cautious, and long-term oriented than legislatures[120].

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[116] *Ibid.* See also Marco Battagalini, "Multiple Referrals and Multidimensional Cheap Talk" (2002) 70:4 Econometrica 1379; Attila Ambrus & Satoru Takahashi, "Multi-Sender Cheap Talk with Restricted State Space" (2008) Harvard University Department of Economics, Working Paper. Cited in De Figueiredo, "Integrated Political Strategy", *supra* note 103 at 8.

[117] *Ibid.* at 2.

[118] See generally, Kenneth J. Meier & John Bohte, *Politics and The Bureaucracy: Policymaking in the Fourth Branch of Government (Brooks / Cole Publishing*, 5th ed. (Belmont, CA: Thompson Wadsworth, 2007) [Meier & Bohte, *Policymaking*].

[119] See Margaret LaBrecque, David Hoyt & Amanda Silverman, "Cellular Telecommunication: An Industry Driven by Intellectual Property and Technical Standards" (case study), (Standford, CA: Board of Trustees of the Leland Junior Stanforf University, 2009).

[120] Meier & Bohte, *Policymaking, supra* note 118.

De Figuereido suggests that firms can use information to influence certain policy outcomes at the agency level. For example, agencies and bureaucracies may rely upon the substantial amount of technical expertise accumulated in certain industries[121]. Reliance on industry will generally happen when administrative agencies lack the appropriate resources to generate sound policy-making or find consensus with industry actors. No studies exist, however, on the effect of lobbying on agency outcomes.

3. Court System

Professor De Figueiredo also points to the fact that courts, including specialized tribunals, have the power to overturn agencies, and in some cases, may even have the willingness to create new policies[122]. It is highly questionable, however, whether courts can be depicted as policy-making entities. There is little empirical evidence to prove that courts engage in policy-making activities on a regular basis. Corporations can certainly use past court rulings to persuade policy-makers about the legality or illegality of government action. They may even seek to provide key information to judges during litigation proceedings. Some courts may even express policy preferences in their judgments. But De Figueiredo is wrong to suggest that courts have the power to consciously and directly influence the competitive landscape. At least in Canada, rulings resulting from judicial review procedures are usually returned to the applicable agency or ministry who will then reconsider the question and issue a new decision. When faced with difficult or controversial questions, courts may invalid the law until the legislature adopts a new amendment. De Figueiredo nevertheless recognizes that "there has

[121] De Figueiredo, "Integrated Political Strategy", *supra* note 103 at 3.

[122] *Ibid.*

been little work done on the role of litigants and the government in [the field] of corporate political strategy"[123].

De Figueiredo suggests that future research in the field of business political activity should be built around four main areas. First, he asserts that the field needs "better theories of how interest group behaviour in multiple institutions affects policy outcomes"[124]. Second, he invites researchers to take current theoretical models and develop testable hypothesis by accumulating data through rigorous empirical methods. Third, he proposes the improvement of empirical data and measures and the development of alternative sources of data. Fourth and last, he hopes that future researchers would find a way to connect the firm's corporate political strategy to policy outcomes, and policy outcomes to the firm's performance. He actually points to Baron's influential research as the only theoretical work that links all three areas[125].

B. Taxonomy of Corporate Political Action

Hillman and Hitt propose a comprehensive taxonomy that addresses how corporations engage in political behaviour. In short, they examine two general approaches to corporate political action (**transactional** and **relational**), two levels of political participation (**individual** and **collective**), and three types of corporate political strategy (**information**, **financial incentive**, and **constituency building**). Their study primarily seeks to explore the formation and implementation of particular strategies chosen by firms and the institutional variables that affect these decisions. Hillman and Hitt propose a decision-tree model of strategy formulation "wherein firms that have decided to be politically active face three sequential decisions: (1)

[123] *Ibid.* at 12.

[124] *Ibid.* at 14.

[125] *Ibid.* at 16.

approach to political strategy, (2) participation level, and (3) specific strategy choices"[126]. **Figure V** below summarizes Hillman & Hill's taxonomy of corporate political strategies.

Figure V: Taxonomy of Political Strategies

STRATEGY	CHARACTERISTICS	TACTICS
Information Strategy	Targets political decision-makers by providing information	• Lobbying • Commissioning research projects and reporting research results • Testifying as expert witnesses • Supplying position papers or technical reports
Financial Incentive Strategy	Targets political decision makers by providing financial incentives	• Contributions to politicians or political party • Honoraria for speaking • Paid travel, etc. • Personal service (hiring people with political experience or having a firm member run for office)
Constituency-Building Strategy	Targets political decision makers indirectly through constituent support	• Grassroots mobilization of employees, suppliers, and customers • Advocacy advertising • Public relations • Press conferences • Political education programs

[126] Hillman & Hitt, "Corporate Political Strategy Formulation", *supra* note 22 at 825.

The strength of their model resides in the fact that it allows researchers to identify signs/symptoms of corporate political action, beyond the most traditional models referred to in the literature which are based solely on informational lobbying and political campaign contributions. Like Bagley, Hillman and Hitt adopt the resource-based view of the firm that presupposes that firms are bundles of resources. For example, they assume that "firms with plentiful resources are more likely to take individual political action, whereas resource-poor firms will use collective political action"[127]. Moreover, they employ institutional and political economy theories to assess the differences that may affect the choice and intensity of corporate political action. They affirm that "as institutional arrangements vary by country, so will firms' political actions"[128].

1. Approaches to Political Action: Transactional or Relational

When proceeding to a step-by-step analysis of their model, Hillman and Hitt contend that three variables are likely to influence a firm's decision to opt for a transactional or relational approach: (1) the degree to which firms are affected by government policy, (2) the level of firm product diversification, and (3) the degree of corporatism/pluralism within the country in which firms are operating[129].

They propose five hypotheses. First, firms with higher perceived or actual dependence on government policy are more likely to use a relational approach to political action. Second, firms with more related-product diversification (or that are single business) are more likely to use a transactional approach to political action. Third, firms with more unrelated-product diversification are more likely to use a transactional approach to political action. Fourth, firms

[127] *Ibid.* at 828.

[128] *Ibid.*

[129] *Ibid.* at 829.

are more likely to use a relational approach to political action in more corporatist countries. Fifth, firms are more likely to use a transactional approach to political action in more pluralist countries.

2. Levels of Political Participation: Individual or Collective

After a firm has decided to pursue its corporate political action under one of the two approaches proposed by Hillman and Hitt, they need to decide whether the actual strategy will be pursued alone or collectively. The authors propose five hypotheses of behaviour. First, firms with greater financial resources and/or other intangible resources, such as knowledge of influencing public policy, are more likely to use individual participation, regardless of approach chosen. Second, firms with fewer financial resources and/or other intangible resources, such as knowledge of influencing public policy, are more likely to use collective participation, regardless of approach chosen. However, they content that firms are more likely to use collective participation in more corporatist countries, regardless of approach chosen, and that firms are more likely to use individual participation in more pluralist countries, regardless of approach chosen.

Quite interestingly, the authors argue that firms may sometimes divide issues into election and non-election issues when seeking to gain popular support, attention, or visibility. They contend that a firm is more likely to use collective participation with election issues and when it has chosen a transactional approach to political strategy.

3. *Corporate Political Strategies: Information, Financial Incentive, and Constituency-Building*

The third and last step relates to the specific strategies firms acting individually or collectively must embrace. Starting from the premise that the public policy process is a market by definition, they contend that the concepts of mutual interdependence and exchange are critical[130]. Exchange theory actually suggests that firms and interest groups may use three strategies to compete in the public policy process, namely information, financial incentives, and constituency building[131].

Moreover, Hillman and Hitt note that a key determinant of political strategy is the current stage of the issue's cycle. For example, interest groups will not employ very different strategies depending on whether the issue is at its formation, formulation, or implementation stage. Ryan, Swanson, and Buchholz refer to public opinion formation and formulation as stages where the issue is emerging and public policy is formulated in response. Public policy implementation, the authors explain, refers to "the bureaucratization of regulation, legislation, and so on (…) during this stage, political action is reactive rather than proactive"[132].

They come up with four hypotheses. First, firms or collectives are more likely to use a constituency-building strategy if the firm or collective has chosen a transactional approach to political action and the issue is in the public opinion formation stage. Second, firms or collectives are more likely to use an information or financial incentive if the firm or collective has chosen a transactional approach to political action and the issue is in the public policy

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[130] *Ibid.* at 833. See also, Kenneth J. Benson, "The Interorganizational Network as a Political Economy" (1975) 20 Administrative Science Quarterly 229; Sumit K. Majumdar & Venkatram Ramaswamy, "Going Direct to Market: The Influence of Exchange Conditions" (1995) 16 Strategic Management Journal 353.

[131] Hillman & Hitt, *ibid.* at 833.

[132] *Ibid.* at 835.

formulation stage. But Hillman and Hitt note that the relational approach spans across issues and time and put the resources of firms and collectives at the centre stage[133]. For example, they contend that credibility and reputation are two key determinants of success in advocacy and public relations, which means that credible firms have an advantage over less credible firms[134]. They also observe that a large number of employees is a positive factor in constituency building and increases the persuasiveness of corporate political strategy[135].

At this stage, they propose two more hypotheses. First, firms or collectives with greater credibility are more likely to use information or constituency-building strategies if the firm or collective has chosen a relational approach to political action. Second, firms or collectives with large employment/membership bases are more likely to use a constituency-building strategy if the firm or collective has chosen a relational approach to political action.

Hillman and Hitt invite researchers to empirically confirm "the distinctness of each of the levels of participation, approach, and strategy should be explored (…) testing of the propositions presented is a critical step"[136] in understanding the dynamics of corporate political strategy and identifying the institutional variables that may affect political strategy. They also suggest research on the areas of implementation and effectiveness of such choices. They note that future studies should examine the variation of tactics in each of the three categories proposed. **Figure VI** below illustrates Hillman and Hitt's decision-tree model of political strategy formulation.

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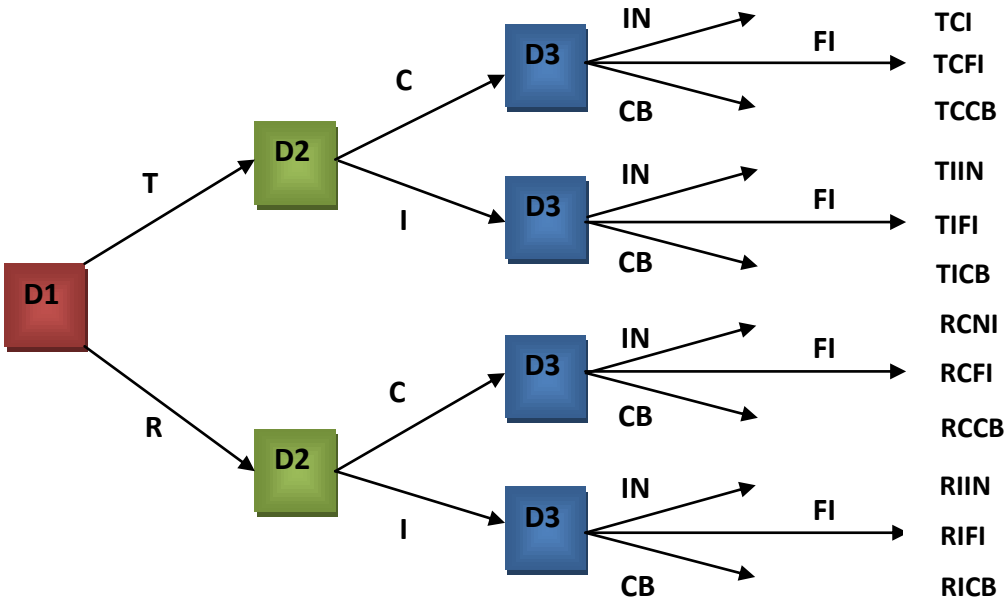
[133] *Ibid.* at 836.

[134] *Ibid.*

[135] *Ibid.* at 836-37.

[136] *Ibid.* at 839.

Figure VI: Decision-Tree Model of Political Strategy Formulation



D1: Approaches
T: Transactional
R: Relational

D2: Participation Level
C: Collective
I: Individual

D3: Strategy Level
IN: Information
FI: Financial Incentive
CB: Constituency-Building

C. Delivering Effective Corporate Political Strategy

Although they do not demystify the link between corporate political strategy and firm profitability[137], Vining, Shapiro and Borges (VSB) convincingly assert the central role of information during the policy-making process, and especially during lobbying activities. In line

[137] See especially, Brian Shaffer, Thomas J. Quasney & Curtis M. Grimm, "Firm Level Performance: Implications of Nonmarket Actions" (2000) 39 Business and Society 126; Abagail McWilliams, David D. Van Fleet & Kenneth D. Cory, "Raising Rivals' Costs through Political Strategy: An Extension of Resource-Based Theory" (2002) 39 Journal of Management Studies 707. See also, George J. Stigler, "The Theory of Economic Regulation" (1971) 2 Bell Journal of Economics and Management 3; Mary K. Olson, "Political Influence and Regulatory Policy: The 1984 Drug Legislation" (1994) 32 Economic Inquiry 363; Schuler, "Corporate Political Strategy", *supra* note 24. Cited in Vining *et al.*, "Lobbying Strategy", *supra* note 22 at 150.

with De Figueiredo, they believe that information remains "the most influential instrument in affecting policy outcomes", far above other type of lobbying tactics such as campaign contributions[138]. They provide the following definition of lobbying: all attempts to communicate information to political actors, including "decisions regarding staff lobbying and contracted-out lobbying, as well as more indirect lobbying through the media or through coalitions with groups that use indirect tactics"[139].

1. Levels and Type of Inclusiveness

In terms of delivery, the authors argue that sound corporate political strategies must be built around five critical elements. First, corporations must choose the **level and type of inclusiveness** of the strategy. They identify six levels of inclusiveness: (1) a firm-specific strategy; (2) an industry segment or strategic group strategy (i.e., small firms in the industry or industry firms in a specific geographical region); (3) an industry-wide strategy; (4) a vertical chain strategy that includes suppliers and buyers; (5) a multiple industry strategy; and (6) an advocacy coalition strategy[140].

About the question of free-riders, they contend that inclusive strategies involving a large number of participants increase the tendency to free-ride[141]. They also note that large firms have a tendency to engage in firm-specific political strategy because "are more able to bear large fixed costs"[142]. Firms can benefit greatly from joining industry-wide coalitions because of the low per-participant costs and greater legitimacy in the eyes of regulators. They note in

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[138] Vining *et al.*, *ibid.* at 151.

[139] *Ibid.*

[140] *Ibid.* at 159.

[141] See also Schuler, "Corporate Political Strategy", *supra* note 24.

[142] Vining *et al.*, "Lobbying Strategy", *supra* note 22 at 160.

particular that heavily concentrated and regulated industries show high levels of political activism. Interestingly, they also note that firms with heterogeneous products – and thus goals – are unlikely to join industry-wide trade associations because their difficulty to find a compromise point that would keep the median firm happy.

2. Form of Arguments and Jurisdictional Venues

Second, according to VSB, firms must decide on the **form of arguments** to be used according to the type of constituencies. In some cases, firms will finance scientific research. In other situations, they may decide to challenge new regulations through the persuasiveness of court arguments[143]. The third element to consider is the **jurisdictional venues** in which the issues will be addressed. For example, in policy areas where a single level of government has exclusive jurisdiction over a specific domain, firms will face a single venue choice. However, as noted by Boddewyn and Brewer, multinational firms will face multiple venues[144]. This may cause difficulties for multinational firms on two grounds, technical and political. For example, "these venues may be on a different continent, conducted in a foreign language, and subject to unfamiliar procedural rules"[145]. In some other cases, building international coalitions may be difficult because there is less history among players that induces trust[146].

3. Organizational Targets and Preferred Delivery Mode

Fourth, firms must assess the **organizational targets** that will need to be engaged. The authors identify a list of potential target audiences: "the chief executive and members of

[143] *Ibid.* at 162.

[144] Jean J. Boddewyn & Thomas L. Brewer, "International-Business Political Behaviour: New Theoretical Directions" (1994) 19 Academy of Management Review 119. Cited in Vining *et al.*, *ibid.* at 164.

[145] Vining *et al.*, *ibid.* at 165.

[146] *Ibid.*

Cabinet; political appointees heading bureaucracies; senior members of the permanent bureaucracy; individual members, or groups of members, of the legislature; members of independent regulatory bodies; the judiciary; or some combination of these"[147], including the international and local media.

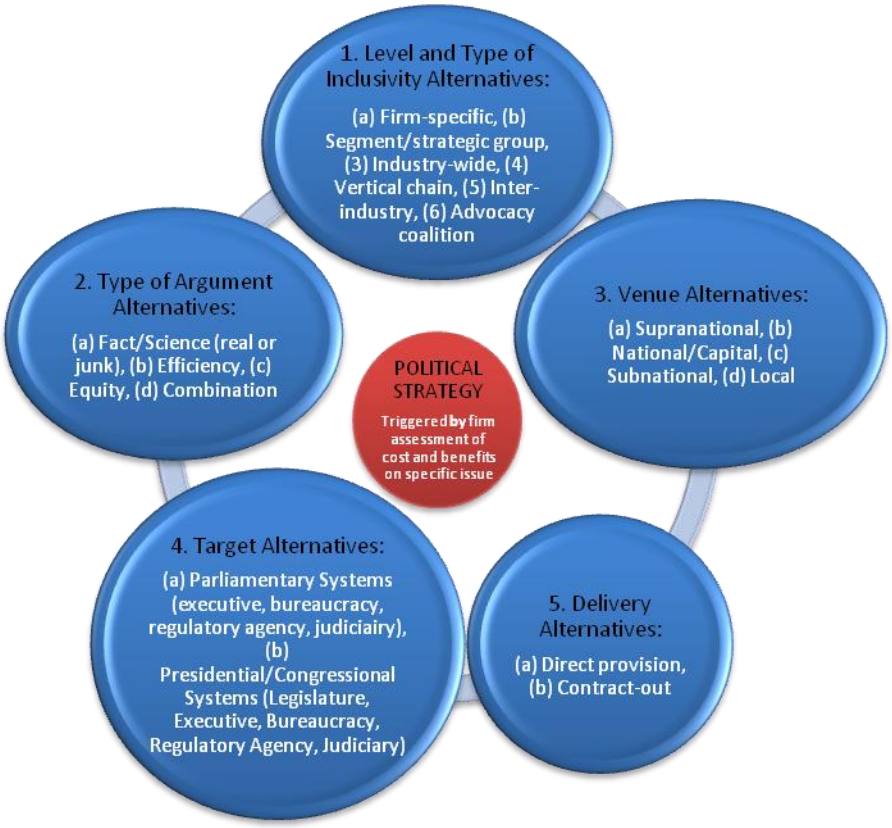
Finally, firms must pick their **preferred delivery mode**. Here, they must decide whether they will engage directly in lobbying activities or whether outsourcing is the best option. According to VSB, "the relative transaction costs should determine the most appropriate mode"[148]. They suggest outsourcing political actions when the outputs pursued by firms are not high-value private goods or when firms only lobbies on a small number of issues. They do not specify, however, whether outsourcing means hiring a lobbying firm or delegating lobbying activities to a specialized entity or joint venture partner. They do not elaborate either on whether certain firms would prefer outsourcing lobbying actions only for those issues that are not part of their core business.

The authors provide a very comprehensive framework on corporate political strategy delivery. In order to better assess the role that corporate political strategy plays across industries and firms, they suggest exploring the following key variables: (1) the nature of the issue (geographic scope, life cycle), (2) the nature of the firm (size, geographical and product diversity), (3) the nature of the industry (concentration, knowledge-based, resource-based) and (4) the nature of the country (legal system, political system). **Figure VII** below is a graphic summary of the corporate political strategy presented by VSB.

[147] *Ibid.* at 166.

[148] *Ibid.* at 168.

Figure VII: The Five Elements of Corporate Political Strategy



IV. Approaches to Legal Astuteness

The use of law for strategic purposes is extensively discussed in the field of strategy management and organizational behaviour. It is common knowledge that heavyweight teams comprised of senior managers and in-house lawyers are usually formed in business environments requiring a high degree of legal sophistication[149]. In industries where firms face constant legal uncertainties and contingencies, Boards of Directors may also choose lawyers to

[149] See especially, Kim B. Clark & Stewen C. Wheelwright, "Organizing and Leading Heavyweight Development Teams" (1992) 34 Cal. Management Rev. 9.

serve as Chief Executive Officers (CEOs)[150]. At the international level, lawyers often act as facilitators of business transactions, more precisely transaction cost engineers with the ability to fill regulatory gaps through contract drafting[151].

As the race for foreign market domination and shareholders' wealth maximization continues, the legal battle has become more sophisticated and subtle than ever. This is particularly the case in industries whose commercial strategies span across jurisdictions, and those subject to heavy government regulation. In a way, it can be posited that managing the legal aspects of business has become a legitimate tool of competitiveness and survival in twenty-first century capitalism. At the outset, the emergence of legally astute managers has created some inevitable challenges for the legal profession.

Today, lawyers are expected to be knowledgeable about their clients' core business. Similarly, in-house lawyers are more involved in corporate strategy and this poses great organizational challenges within firms. As pointed out by DeMott, "[T]o the extent that general counsel participates at an early stage in shaping major transactions and corporate policy, counsel's ability to bring detached, professional judgment (…) may be compromised, especially when the question of legality is tinged in shades of grey as opposed to black and white"[152]. Although a discussion on the ethical hurdles encountered by lawyers acting as corporate strategists is out of the scope of this thesis, some general observations will be made as the processes of formulation and implementation of legal strategies is further explored in the next pages. The following discussion explores existing theories of corporate legal strategy from

[150] See especially, Jeffrey Pfeffer & Gerald R. Salancik, *The External of Organizations: Resource Dependence Perspective* (Stanford, CA: Stanford University Press, 2003) [Pfeffer & Salancik, "The External of Organizations"].

[151] See Ronald J. Gilson, "Value Creation by Business Lawyers: Legal Skills and Asset Pricing" (1984) 94 Yale L. J. 239.

[152] Deborah A. DeMott, "Colloquium Ethics in Corporate Representation: the Discrete Roles of General Counsel" (2005) 74 Fordham L. Rev. 955.

various perspectives. The theories presented make a serious attempt at enlightening current management theories such as Baron's nonmarket strategies and Vining, Shapiro, and Borges' delivery model of corporate political strategy. They are also a great supplement to Hillman and Hitt and De Figuereido theories of corporate political action.

A. Legal Astuteness Enhances the Firm's Ability to Innovate and Adapt

Constance E. Bagley postulates that, under the resource-based view of the firm[153], legal astuteness can be considered a valuable capability that enhances the firm's ability to innovate and adapt to changing technological, market, and institutional conditions"[154]. She contends that legal astuteness, as a distinctive managerial capability, must be **valuable**, **inimitable**, **nonsubstitutable**, and **rare** in order to become a realizable competitive advantage. Recognizing that top management teams (TMT) are one of the most critical resources in achieving successful corporate strategies, she defines legal astuteness in the following terms: "the ability of a TMT to communicate effectively with counsel and to work together to solve complex legal problems"[155]. Further, she contends that "failure to integrate law into the development of strategy and action plans can place a firm at a competitive disadvantage and imperil its economic viability"[156]. Her definition of law includes the constitution, statutes enacted by federal and provincial/state legislatures, regulations promulgated by all levels of government, laws and regulations administered by regulatory and enforcement agencies, and the common law of courts.

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[153] Barney, "Firm Resources", *supra* note 72. ("A capability confers competitive advantage under the resource-based view of the firm only if it is valuable, inimitable, nonsubstitutable, and rare.")

[154] Bagley, "Legal Astuteness", *supra* note 73. See also, David J. Teece, Gary Pisano & Amy Shuen, "Dynamic Capabilities and Strategic Management" (1997) 18 Strategic Management Journal 509-33.

[155] Bagley, *ibid.* at 378.

[156] *Ibid.* at 379.

To a certain extent, Bagley's theoretical model implicitly acknowledges the nonmarket environment described by Baron because she assumes that the law must be "managed" in by the TMT. Her theory also presupposes the existence of a legal sphere similar to that proposed by Roquilly because she recognizes that legally astute teams are proactive by definition and often convert regulatory constraints into opportunities. In Bagley's words, "legally astute managers call on their lawyers to play an active and ongoing role in formulating and executing firm strategy. They demand legal advice that is business oriented, and they expect their lawyers to help them address business opportunities and threats in ways that are legally permissible, effective, and efficient"[157].

1. The Core Values of Legal Astuteness

Bagley contends that four components must be present in legally astute firms: "(1) a set of value-laden attitudes, (2) a proactive approach, (3) the ability to exercise informed judgment, and (4) context-specific knowledge of the relevant law and the appropriate application of legal tools"[158].

a) The Attitudinal Component

According to Bagley's theory of legal astuteness, TMTs understand the importance of anticipating how current laws will be interpreted and enforced in the future. More importantly, they take responsibility for managing the legal aspects of the firm because they understand that the regulatory environment influences and shapes economic activity. Further, she suggests that "legally astute teams embrace the rule of law and recognize the moral aspects

[157] Constance E. Bagley, "Foreword" in Antoine Masson & Mary J. Shariff, eds., *Legal Strategies: How Corporations Use Law to Improve Performance* (Berlin: Springer, 2010).

[158] Bagley, "Legal Astuteness", *supra* note 73 at 379.

of strategic choice"[159]. Like North, she recognizes that law establishes the rules of the game for firms competing in the economic sphere[160], and that it is ultimately the role of the TMT to decide whether a particular risk is worth accepting or a particular opportunity is worth pursuing.

b) The Proactive and Judgment Components

Bagley contends that legally astute teams do not perceive the law as a constraining "necessary evil" of business activity. They usually take a proactive approach to government regulation and ask their lawyers to help them take advantage of the business opportunities that new regulation or deregulation offer. In other words, lawyers are expected to act as "counsel" or "entrepreneurs", not only as "cops"[161]. Legally astute managers do not treat their lawyers as technical consultants, that is employees or external consultants "to be brought in on an episodic basis when the firm is confronted with a discrete legal problem or after the management team has already decided what to do"[162]. In Bagley's view, legally astute teams will also ask their lawyers to provide technical advice on the black-letter aspects of the law, but with a touch of judgment and wisdom. After all, she observes, "certain courses of action maybe legal but not wise"[163]. They understand that legal dispute is above all a "business problem requiring a business solution"[164].

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[159] *Ibid.* at 380.

[160] Douglass C. North, *Institutions, Institutional Change and Economic Performance* (Cambridge, UK: Cambridge University Press, 1990).

[161] See especially, Robert L. Nelson & Laura B. Nielsen, "Cops, Counsel, and Entrepreneurs: Constructing the Role of Inside Counsel in Large Corporations" (2000) 34 Law and Society Review 457.

[162] Bagley, "Legal Astuteness", *supra* note 73 at 381.

[163] *Ibid.*

[164] *Ibid.* at 382.

c) The Knowledge Component

Bagley suggests that legally astute managers must attain a certain degree of legal literacy in order to communicate effectively with their lawyers. They must also possess a general knowledge of the legal tools that could help them create value for the firm. In a study presenting three cases from the airline industry, Hinthorne contends that "lawyers and corporate leaders who understand the law and the structures of power in the U.S.A. have a unique capacity to protect and enhance share-owner wealth"[165]. This is likely the case in all industries heavily regulated by government such as pharmaceuticals and telecommunications. In Bagley's words, "managers who can harness the creative power of legal language are more adept at seeing and shaping the legal structure of their world"[166].

2. Legal Astuteness in Action

Bagley contends that legally astute managers must have the ability to identify opportunities to use the law to increase the firm's overall value and competitive advantage according to four approaches. For example, they can "(1) use formal contracts as complements to relational governance to define and strengthen relationships and reduce transactions costs, (2) protect and enhance the realizable value of firm resources, (3) use contracts and other legal tools to create options, and (4) convert regulatory constraints into opportunities"[167].

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[165] Tom Hinthorne, "Predatory Capitalism, Pragmatism, and Legal Positivism in the Airline Industry" (1996) 17 Strategic Management Journal 251.

[166] Bagley, "Legal Astuteness", *supra* note 73 at 383.

[167] *Ibid.*

a) Reduction of Transaction Costs

Despite well-established relational governance structures and long-term business relationships with suppliers, legally astute firms may also benefit from using formal contracts to protect against opportunism. For instance, long-term contracts can protect a seller from the instability resulting from depending on one or two critical buyers[168]. In some cases, firms may consider joint venture structures "to stabilize exchange relationships, especially when operating in a highly interconnected environment"[169]. There is empirical evidence proving that formal contracts and relational governance can be complements[170]. Finally, Bagley suggests that managers who participate in contract negotiations acquire the ability to understand the business implications of various negotiation positions, and thus are in a better position to instruct their lawyers.

b) Protection of Valuable Firm Resources

Bagley emphasizes the importance of using legal tools to leverage the value firm resources such as proprietary technology. She notes that intellectual property law provides firms with the legal tools to protect the value of knowledge. In some cases, she recognizes, "intellectually property rights can be used both offensively to shut down a competing line of business, as happened when Polaroid used its patents to shut down Kodak's instant camera and film business"[171]. However, she fails to provide other examples of legal strategies that legally astute firms may use to protect their valuable resources outside the realm of intellectual property law.

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[168] *Ibid.* at 384.

[169] *Ibid.* See especially, Pfeffer & Salancik, "The External of Organizations", *supra* note 150.

[170] Laura Poppo & Todd Zenger, "Do Formal Contracts and Relational Governance Function as Substitutes or Complements?" (2002) 23 Strategic Management Journal 707.

[171] Bagley, "Legal Astuteness", *supra* note 73 at 385.

In the airline industry, for example, market share can be a valuable firm resource that thrusts predatory practices and exclusivity marketing agreements.

c) Use of Legal Tools to Create Value

The third approach to legal astuteness is based on the conscious use of "the right to defer a decision until additional information become available or until uncertainties are otherwise resolved"[172]. For example, the firm's decision to pursue litigation or to propose a settlement can sometimes be viewed as a strategic deferral of an option[173]. Bagley provides other examples: the right to acquire real property, the option to buy a stock, and the right to terminate a joint venture. She contends that "TMTs who understand how to use such tools effectively should achieve higher levels of performance than those lacking that capability"[174].

d) Conversion of Regulatory Constraints into Opportunities

In tune with Roquilly and Baron, Bagley proposes that legally astute firms should monitor the nonmarket/legal landscape in search of potential unforeseen opportunities. As will be discussed in subsequent chapters, start-up airlines can benefit from monitoring regulatory changes and capitalize on their competitor's faulty legal astuteness. At the same time, Bagley contends that firms must have adequate compliance programs in place to protect the long-term viability of the firm and avoid penalties: "In addition to the direct costs of sanctions (such as fines and punitive damages) and the legal costs associated with litigation and appeals,

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[172] *Ibid.* at 386.

[173] Joseph A. Grundfest & Peter H. Huang, "The Unexpected Value of Litigation: A Real Options Perspective" (2006) 58 Stanford L. Rev. 1267.

[174] Bagley, "Legal Astuteness", *supra* note 73 at 386.

illegality can divert funds from strategic investments, tarnish a firm's image with customers and other stakeholders, raise capital costs, and reduce sales volume"[175].

3. Future Questions for Research

In her conclusion, Bagley recognizes that empirical research is necessary to further assess the role of "legal astuteness in the achievement and sustainability of competitive advantage"[176]. She invites researchers to consider the following questions: (1) What organizational structures are best suited for achieving the benefits of legal astuteness? (2) Is legal astuteness a rare phenomenon? Are there certain industries in which legal considerations are prevalent? **Figure VIII** below illustrates the different degrees of legal astuteness based on the attitudes of the top management team (TMT).

Figure VIII – Legal Astuteness and Attitudinal Assessment of Top Management Teams

CHARACTERISTICS	LOW DEGREE OF LEGAL ASTUTENESS	HIGH DEGREE OF LEGAL ASTUTNESS
Attitude of TMT toward legal dimensions of business	Not my responsibility!	Important part of my job!
TMT view of lawyers	"Necessary Evil"	Partner in value creation and risk management
Role of General Counsel (GC)	Cop	Counsel / Entrepreneur
Frequency of GC contact with CEO and top management	Low	High

[175] *Ibid.*

[176] *Ibid.* at 387.

Flow of business information and legal queries	On a discrete issue-per-issue basis	Ongoing
GC is member of the top management team (TMT)	No	Yes
TMT approach to legal issues	Reactive	Proactive
Involvement of TMT in managing legal aspects of business	Hands off!	Hands on!
TMT approach to regulation	Do minimum to comply	Exceed regulatory requirements as result of operational changes that increase realizable value
Involvement of lawyers in strategy formation	Low	High
Involvement of managers in resolving business disputes	Low	High
Involvement of managers in contract negotiation	Low	High
Involvement of managers in striking deals	Low	High
Legal literacy of managers	Low	High
Business acumen of lawyers	Low	High

B. Law Can Be a Strategic Tool of Competitive Advantage

The most recent scholarly attempt to address the issues of value creation and risk management through proactive legal strategies is Antoine Masson and Mary J. Shariff's *Legal*

Strategies: How Corporations Use Law to Improve Performance[177]. In this book, the authors contend that the law is no longer perceived by senior management as an external constraint to which corporations should simply comply (the static view of the law), but rather as a strategic tool that can be anticipated and instrumentally used in light of specific business objectives (the malleable view of the law). Perhaps their most compelling observation is that senior managers are moving from an excessively positivist approach to a more strategic and proactive stand, especially in heavily regulated and globalized industries. This view certainly echoes Bagley's theory of legal astuteness. In support of the authors' argument, it is worth noticing that there is scientific evidence that bringing together managers and lawyers may have a positive impact on problem-solving endeavours[178] and overall team performance[179].

In line with the resource-based view of the firm proposed by Barney, Masson and Sheriff are primarily interested with exploring how legal resources can be mobilized and allocated by corporations to achieve competitive advantage. They assume that well-crafted corporate legal strategies can minimize risks for the corporation while increasing its profitability levels. Masson and Sheriff define corporate legal strategies as "plans of action by corporations that involve the evaluation, incorporation and manipulation of law, legal frameworks and legal players in order to increase the bottom line"[180].

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[177] Masson & Shariff, "Legal Strategies", *supra* note 74.

[178] Sara L. Keck, "Top Management Team Structure: Differential Effects by Environmental Context" (1997) 8 Organization Science 143.

[179] Deborah G. Acona & David P. Caldwell, "Demography and Design: Predictors of New Product Team Performance" (1992) 3 Organization Science 323.

[180] Masson & Shariff, "Legal Strategies", *supra* note 74 at ix (Preface).

1. Vertical Dimension of Legal Strategies

Trevor Anderson starts his analysis by asking which "legal choices/means may be adopted [by corporations] to achieve a desired business or economic outcome"[181]. He predicts that corporations will typically respond according to two dimensions.

The vertical dimension refers to ways "in which the corporation may, as a litigant or party, influence the legal or economic outcome of litigation or a regulatory process"[182]. In practice, a corporation adopting a vertical dimension will attempt to use the effect of time during litigation proceedings and will also try to exploit the uneven playing field between two litigating parties. In most cases, it will endeavour to influence litigation resolution through burdensome evidentiary and forum shopping tactics[183]. In other cases, a corporation may try to avoid public court proceedings by imposing private dispute resolution methods on other parties such as mandatory arbitration.

In a purely Machiavellian fashion, the vertical dimension can also include initiating strategic litigation against certain regulatory bodies in order to obtain "lighter" regulation for the benefit of a particular industry[184]. In sum, vertical legal strategies are closely related to what can be termed as "the manipulation of the rules of procedure and evidence" and "the conscious attempt to water-down intrusive legislation through numerous court challenges". Vertical legal strategies are definitely time sensitive and usually involve a dispassionate, matter-

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[181] D. Trevor Anderson, "Introduction" in Antoine Masson & Mary J. Shariff, *Legal Strategies: How Corporations Use Law to Improve Performance* (Berlin: Springer, 2010) at 1 [Anderson, "Introduction"].

[182] *Ibid.*

[183] *Ibid.* at 2.

[184] See especially, Eveline Hellebuyck, "Activist Hedge Funds and Legal Strategy Devices" in Antoine Masson & Mary J. Shariff, *Legal Strategies: How Corporations Use Law to Improve Performance* (Berlin: Springer, 2010) at 277-92.

of-fact assessment of the relative strength of litigant parties. Contrary to horizontal legal strategies, they are deeply embedded in the adversarial process.

2. Horizontal Dimension of Legal Strategies

The horizontal dimension proposed by Anderson focuses on "the use of legal strategies, on an ongoing basis, to secure competitive advantage against corporate competitors"[185]. Riding on the goodwill of a brand by using ambush marketing techniques or securing intellectual property rights before other competitors are good examples of horizontal legal strategies. Another example may be the creation of insulated legal regimes in weak states or territories with limited business law and regulation[186].

From an organizational perspective, horizontal legal strategies are primarily concerned with the integration of legal strategies within corporate strategy and planning. In other words, they focus on the development of core legal competencies within corporations, which may include functional units such as compliance departments, as well as the creation and use of government relations and regulatory affairs offices. Horizontal legal strategies are resolutely embedded in the broader corporate strategy process.

The Anderson model undoubtedly possesses some descriptive and conceptual value. However, it fails to address how corporations actually formalize the use of law as a strategic tool to achieve competitiveness. In other words, why do corporations adopt vertical instead of horizontal legal strategies? A more generalizable theory would address questions such as: (1) which factors tend to determine corporate legal action; (2) who defines or controls those

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[185] Anderson, "Introduction", *supra* note 181 at 2.

[186] See particularly, Doreen McBarnet, "Transnational Transactions: Legal Work, Cross-Border Commerce and Global Regulation" in Antoine Masson & Mary J. Shariff, *Legal Strategies: How Corporations Use Law to Improve Performance* (Berlin: Springer, 2010) at 369.

factors; (3) are there any exogenous forces that influence corporate legal strategies; and (4) how corporations exercise influence on those factors.

C. Approaches to Legal Strategies

1. Development and Accumulation of Legal Competencies

Roquilly suggests that "firms must learn to integrate the elements from the legal sphere into the development of their internal resources and legal capability"[187]. In order to attain sustainable competitive advantage, he argues, firms cannot simply observe and react to threats and opportunities arising from the external environment. He contends that "it is the combination of resources, capabilities and core competencies that [ultimately] leads to a sustainable competitive advantage"[188].

Roquilly defines legal resources as "resources that generate rights (particularly property rights) and can be considered as object-resources" [189]. He explains that property-based legal resources such as contracts, corporate structures, and intellectual property rights can provide protection, secure or increase the value of other non-legal resources within the corporation and generate enforceable rights that benefit the corporation[190]. For instance, he notes, the law of trademarks provides a sound legal structure for future marketing innovation and patent law

[187] Roquilly, "Legal Core Competency", *supra* note 70 at 16.
[188] *Ibid.* at 17.
[189] *Ibid.*
[190] *Ibid.*

supports technological innovation[191]. Also, strategic contracts can provide structure to the relationships between manufacturers, distributors, vendors, and commercial partners[192].

Roquilly emphasizes the importance of accumulating legal resources within the firm in order to remain competitive. To illustrate his point, he refers to Bayer's legal strategy to combine patent and trademark law so "as to continue to generate high income even after the expiration of the patent on aspirin"[193]. He also mentions Disney's strategy of diversification– i.e., the accumulation of copyright and trademark rights over the same cartoon characters – in order to generate major opportunities in terms of licensing agreements and by-products[194]. Ultimately, he notes that the vast size of a patent portfolio within a given corporation may facilitate new commercial transactions because costly legal proceedings can be avoided[195]. Roquilly warns, however, that the "deployment of legal resources, must be done appropriately in respect to the external environment"[196], which also includes taking into account regulatory provisions in the area of competition/antitrust law. For example, he suggests, firms should avoid engaging into aggressive tactics that could potentially alter the competition game and artificially block the entrance of competitors in specific markets[197].

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[191] See particularly, Wesley M. Cohen, Richard R. Nelson & John P. Walsh, "Protecting Their Intellectual Assets: Appropriability Conditions and Why U.S. Manufacturing Firms Patent (or Not)" (2000) National Bureau of Economic Research, Working Paper #7552.

[192] John Hagedoorn & Geert Duysters, "External Sources of Innovative Capabilities: The Preference for Strategic Alliances or Mergers and Acquisitions" (2002) 39:2 Journal of Management Studies 167.

[193] Markus Reitzig, "Strategic Management of Intellectual Property" (2004) 45:3 MIT Sloan Management Review 35.

[194] Roquilly, "Legal Core Competency", *supra* note 70 at 18.

[195] See particularly, Jean O. Lanjouw & Mark Schankermann, "Protecting Intellectual Property Rights: Are Small Firms Handicapped?" (2004) 47:1 J. of Law and Econ. 45.

[196] Roquilly, "Legal Core Competency", *supra* note 70 at 19.

[197] Mark M. Lemley, "A New Balance Between IP and Antitrust" (2007) 13 Southwestern Journal of Law and Trade in Americas 237.

Roquilly makes a number of final observations. First, he contends that achieving legal competency requires a well planned legal risk management system[198]. Second, he argues that legal competency must, in all cases, be dynamic. In other words, there must be processes and systems in place that combine information, knowledge and know-how, which in turn facilitate the exchange of legal and non-legal information with the aim of coordinating "the elements of the environment with the legal and non-legal resources"[199]. In tune with Bagley's theory, he notes that acquired legal competencies must be valuable, rare, inimitable, or costly to imitate and non substitutable[200]. Finally, he suggests that "the more legal experts are perceived as creators of resources and as holding the potential to improve a firm's performance, the more a firm's legal culture will be an integral part of its corporate culture"[201]. This certainly echoes Bagley's theory of legal astuteness.

2. Controlling Legal Outcomes through Litigation Strategies

LoPucki and Weyrauch present a controversial theory of legal strategy in which courts – and judges – are no longer the most important arbiters of legal outcomes. According to the authors, lawyers and senior managers ("the legal strategists") are nowadays the main engineers of legal outcomes "in what amounts to a contest of skill"[202]. They define legal strategist as someone who "works with decision-makers, facts, legal cultures, and law"[203]. The category of

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[198] Roquilly, "Legal Core Competency", *supra* note 70 at 20.

[199] *Ibid.* at 20-22.

[200] *Ibid.* at 22.

[201] *Ibid.* at 24.

[202] Lynn M. LoPucki & Walter O. Weyrauch, "A Theory of Legal Strategy" in Antoine Masson & Mary J. Shariff, *Legal Strategies: How Corporations Use Law to Improve Performance* (Berlin: Springer, 2010) at 41 [LoPucki & Weyrauch, "A Theory of Legal Strategy"].

[203] *Ibid.* at 47.

"decision-makers" includes judges, juries, arbitrators, administrators, boards, commissions, lawyers, and parties. Facts are defined as events, both past and future, that can be translated into "statements of fact, evidence, testimony, records, and finally the facts stated in court opinions"[204]. Legal culture comprises "sets of practices, perceptions, and expectations that differ from group to group and are often outcome-determinative"[205]. Finally, the conception of law embraced by the authors can be referred to as "delivered law", that is the pattern of outcomes the legal system ultimately delivers.

LoPucki and Weyrauch are critical of so-called conventional views of the legal process[206], particularly those in which the role of lawyers is limited to gathering facts, conducting research, and persuading the courts to decide in their clients' favour[207]. They contend that one of the reasons why lawyers do not like to admit – publicly – that they engage in strategy is because the use of strategy is often condemned as unethical[208]. Adopting a resolutely realist perspective, LoPucki and Weyrauch suggest that "lawyers devote substantial time and energy to the development of legal strategies and regard them as capable of determining outcomes across

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[204] *Ibid.*

[205] *Ibid.*

[206] See particularly, Ruggero J. Aldisert, *Logic for Lawyers: a Guide to Clear Legal Thinking* (Contemporary Medical Education, 1992) at 2-4 ("The common-law decisional process starts with the finding of facts in a dispute by a fact-finder, be it a jury, judge, or administrative agency. Once the facts are ascertained, the court compares them with fact patterns from previous cases and decides if there is sufficient similarity to warrant applying the rule of an earlier case to the facts of the present one.")

[207] For a model in which the primary objective of litigating parties is to win rules of law favourable to their own side, see Marc Galanter, "Why the Haves Come Out Ahead: Speculations on the Limits of Legal Change" (1974) 9 Law & Society Rev. 96.

[208] See particularly, Leo Katz, "Form and Substance in Law and Morality" (1999) 66 U. Chi. L. Rev. 566 [Katz, "Form and Substance"] (The author defines strategy as "the art of devising or employing plans or stratagems toward a goal" and concludes that "lawyers routinely exploit the law"). For a study on the psychological leverage during negotiation settlements that plaintiffs have in cases of frivolous litigation, see Chris Guthrie, "Framing Frivolous Litigation: A Psychological Theory" (2000) 67:1 U. Chi. L. Rev. 163.

a wide spectrum of cases"[209]. They claim that the conventional view still finds supporters in the academy because of the many "unpleasant consequences" that result from the strategic view. Further, they also attempt to differentiate their strategic view model from the dominant law and economics model based on game theory: "[T]he economic model treats the lawmaker – like the game designer – as omnipotent. In that model, players cannot challenge the rules; they can only seek advantage under them. Yet a central thrust of legal strategy is to control legal outcomes despite the contrary intentions of legislators or judges"[210].

LoPucki and Weyrauch contend that their theory of legal strategy can explain "several phenomena for which current explanations are inadequate or nonexistent"[211]. First, they contend that realist observations of the legal system "in operation" suggest that there is a positive correlation between superior lawyering skills and legal outcomes. Second, they are capable of explaining large variations in legal outcomes among jurisdictions by considering local legal cultures, i.e., social norms, the law in lawyer's heads, and idiosyncratic expectations regarding legal outcomes. Third, they take into account the important role of resources in determining legal outcomes: "resources matter because they unleash strategy, and strategy is capable of altering legal outcomes across a wide range of possibilities"[212]. They also note that because of the legal fees' systems in place, the wealthier side will be able to afford the best

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[209] LoPucki & Weyrauch, "A Theory of Legal Strategy", *supra* note 202 at 44. The authors identify a number of publications that are devoted to legal strategy. For example, *Bankruptcy Strategist, Computer Law Strategist, Corporate Tax Strategy, The Journal of Strategy in International Taxation, Deposition Strategy: Law and Forms, Employment Law Strategist, Intellectual Property Strategist*. See also, David B. Baum *et al., Advanced Negligence Trial Strategy* (New York, NY: Practicing Law Institute, 1979); Xavier M. Frascogna, *Negotiation Strategy for Lawyers* (Upper Saddle River, NJ: Prentice-Hall, 1984); Simon N. Gazan, *Encyclopedia of Trial Strategy and Tactics* (Upper Saddle River, NJ: Prentice-Hall, 1962).

[210] LoPucki & Weyrauch, *ibid.* at 45.

[211] *Ibid.* at 78.

[212] *Ibid.* at 84.

advocates. Finally, they recognize that empirical research in this field may be problematic because the best strategists know that strategies work best when unnoticed, thus identification and articulation of legal strategies becomes problematic for the researcher. They claim, however, that careful observers can piece them together through a review of public records and an analysis of public hearings. They further contend that "in the coming age of information, the task of articulating legal strategy may become easier"[213] because the computerization of the legal process may facilitate the search and documentation of cases, outcomes, and patterns.

In contrast with the conventional view that conceives written law as a set of rules that govern social interactions and dispute resolution processes, the authors perceive legal outcomes as "the product of complex interactions among written laws, law in lawyers' heads, social norms, actions of officials, system imperatives, and expectations regarding outcomes"[214]. In their attempt to formulate a generalizable theory of legal strategy, LoPucki and Weyrauch focus primarily on "what lawyers do when they strategize" and provide a classification of legal strategies: (1) those that require willing acceptance by judges ("strategies of persuasion"), (2) those that constrain the actions of judges ("strategies of constraint"), and (3) those that entirely deprive judges of control ("strategies of judicial deprivation")[215].

a) Strategies of Persuasion

Strategies of persuasion seek primarily to persuade the decision-maker to rule in the strategists' favour, regardless of the merits of the case. These strategies may include adopting

[213] *Ibid.* at 86.

[214] *Ibid.* at 51.

[215] *Ibid.* at 41.

certain mannerisms, using certain levels of speech and rhetorical techniques[216], or dressing like the decision-maker in order to establish a bond[217]. They can also include undermining the credibility of adverse witnesses through the use of rhetorical techniques like theme exploitation, repetition or innuendo[218]. When one of the parties is unable to find ambiguity in the legal arguments – and legal rules – brought forward by the other party, it can turn to a number of so-called "meta-rules", namely "the rule is unconstitutional, the rule was not properly adopted, the rule is not authoritative in this jurisdiction, the (statutory) rule constitutes a scrivener's error, the rule should be changed because of changes in technology and society (...)"[219]. According to the authors, whenever parties are too skilful in manipulating the written law, "the written law ultimately proves at least plausibly indeterminate"[220]. They also note that untested legal rules can be easily manipulated by skilful lawyers when there is no consensus as to the appropriate technical or particular legal interpretation that should be considered "correct".

b) Strategies of Constraint

Strategies of constraint will pressure judges to decide in the strategists' favour, but without seeking to persuade the decision-makers on the merits of the case. They include case selection,

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[216] See particularly, Peter L. Murray, *Basic Trial Advocacy,* 1st ed. (Standish, ME: Maine Law Book Co. / Tower Publishing, 1995). See also, Ervin A. Gonzalez, "Creating and Developing Winning Themes and Arguments" (1988) Feb. Fla. B.J. 53 ("Your trial plan should be built around a theme that will define the case and will allow the jury to rally around that theme.")

[217] See, Roger S. Haydock & John Sonsteng, *Trial: Theories, Tactics, Techniques* (St. Paul, MN: West Group, 1991) at 55 ("Attorneys may have to put aside personal tastes and conform their dress to the standards of a community or judge so as to safeguard and promote the best interests of a client.")

[218] LoPucki & Weyrauch, "A Theory of Legal Strategy", *supra* note 202 at 58.

[219] *Ibid.* at 59.

[220] *Ibid.* at 60.

making a record, legal planning, and media spin[221]. For example, plaintiffs can select to litigate only those cases that are most likely to make favourable law and dismiss those that can trigger unpromising legal outcomes. As pointed out by Macaulay, automobile manufacturers have often resorted to case selection techniques to avoid liability or to diminish the amount of damages in their favour[222]. Making a record can also be an effective strategy when lawyers want to maximize the chances of reversal on appeal. For example, they can object to questions posed by the other party more than frequently. They can incite the trial judge to commit an appealable error. They can also submit evidence or testimony of questionable admissibility or may even try to induce the court into reversible error by failing to argue effectively in first instance[223]. Legal planning refers to a lawyer's conscious attempt to create fact patterns that would ultimately "satisfy the antecedents of legal rules, and thus achieving the desired results"[224] for his client. Finally, and although this fourth element may only be applicable in criminal, family and civil rights cases, media spin remains an important element of constraint because members of the judiciary are typically preoccupied by the perceptions that members of the profession and the public in general have about them, and especially in those jurisdictions where the judges are elected by constituents[225].

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[221] *Ibid.* at 61.

[222] See particularly, Stewart Macaulay, *Law and the Balance of Power: the Automobile Manufacturers and their Dealers* (New York, NY: Russell Sage Foundation, 1966) at 96-133.

[223] LoPucki & Weyrauch, "A Theory of Legal Strategy", *supra* note 202 at 64.

[224] See Katz, "Form and Substance", *supra* note 208 ("A lawyer recommends that a client turn most of its employees into independent contractors to escape the burden of social security taxes or even simple tort liability" or "A lawyer suggests to a client who owns a farm that she incorporate the farm and declare herself its employee in order to qualify for social security.")

[225] LoPucki & Weyrauch, "A Theory of Legal Strategy", *supra* note 202 at 66-67.

c) Strategies of Judicial Deprivation

Strategies of judicial deprivation are aimed at preventing the other side from obtaining adjudication or, in some cases, to control who the adjudicator is likely to be[226]. They may include increasing the cost of litigation for the other party in various ways. For example, expanding the issues in litigation may broaden the scope of discovery and force parties to employ expensive experts or to take depositions in remote areas, which will ultimately increase the amount of money spent by plaintiffs or defendants to prepare for trial. Alternatively, deep pocket corporations or industries may announce that they will defend every court challenge brought against them, up until the highest court levels, and will not consider settlement proposals[227]. Another example is the use of delay strategies in order to reduce the expected value of a lawsuit for the plaintiff. Key witnesses may not be available, evidence may be destroyed, case law may change, or "the judgment for damages might not be collectible"[228]. Plaintiffs may then become discouraged or less willing to allocate financial resources to succeed. The third example of judicial deprivation – the use of extralegal strategies – seeks to deter "those entitled to legal remedies from suing or from continuing suits already filed"[229]. These strategies can range from courteous treatment of potential plaintiffs to implicit threats of "unwanted publicity, the loss of a job, criminal prosecution, deportation, or embarrassment in matters having no direct relationship to the litigation"[230].

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[226] *Ibid.* at 67.

[227] See particularly, Robert L. Rabin, "A Socio-legal History of the Tobacco Tort Litigation" (1992) 44 Stan. L. Rev. 857 at 874 ("Thus, after thirty years of litigation, the tobacco industry could still maintain the notable claim that it had not paid out a cent in tort awards.")

[228] Lynn M. LoPucki, "The Death of Liability" (1996) 106 Yale L.J. 1 at 14-38.

[229] LoPucki & Weyrauch, "A Theory of Legal Strategy", *supra* note 202 at 70.

[230] *Ibid.* at 70-71.

The use of abusive contractual strategies may also deprive judges to intervene in what would be otherwise meritorious cases. The authors refer to examples where contracts "require arbitration of customer claims against industry arbitrators whose primary loyalty is likely to be to the industry"[231]. Contractual strategies can also attempt to shift risks to persons who are unable to understand basic liability concepts, let alone assessing the magnitude of the risk. Forum strategies are common practice in litigation proceedings and may be used by both plaintiffs and defendants with the idea of maximizing their chances that local courts will rule in their favour[232]. The authors note that existing doctrines of forum *non conveniens* and related legislation "fall short of providing an antidote to forum shopping for legal outcomes"[233], despite the existence of empirical studies suggesting that "the struggle over venue is often outcome-determinative"[234]. Settlement strategies are generally perceived by legal scholars as schemes that involve "bargaining in the shadow of the law"[235] or tools to reach the same result those parties would have reached through litigation.

3. Deployment of Legal Resources and Development of Internal Capabilities

According to the dominant managerial approach, "it is the legal capacity of each firm (i.e., the combination of know-how, knowledge and pro-active management of both internal and external legal information flow) which gives it the possibility to deploy, in an efficient manner,

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[231] *Ibid.* at 72.

[232] See David W. Robertson, "The Federal Doctrine of Forum Non Conveniens: An Object Lesson in Uncontrolled Discretion" (1994) 29 Tex. Int'l L.J. at 354-55. See also, Erwin Chemerinsky, "Rationalizing Jurisdiction" (1992) 42 Emory L.J. 7 ("A plaintiff trying to avoid removal to federal court might add defendants who are from the same state.")

[233] LoPucki & Weyrauch, "A Theory of Legal Strategy", *supra* note 202 at 75.

[234] *Ibid.* See particularly, Kerwin M. Clermont & Theodore Eisenberg, "Exorcising the Evil of Forum Shopping" (1995) 80 Cornell L. Rev. 1507.

[235] Robert H. Mnookin & Lewis Kornhauser, "Bargaining in the Shadow of the Law: the Case of Divorce" (1979) 88 Yale L.J. 997.

its legal resources in order to achieve its business objectives and consequently to take advantage of its legal environment"[236]. Masson attempts to identify the factors that are likely to create legal capabilities within firms. He looks particularly at the circumstances and/or contexts under which corporations might decide to invest non-legal resources – financial, technical, and human – to enhance their own internal legal capabilities. He contends that a firm's core legal capability determines its capacity to formulate and implement legal strategies in the long-term.

According to Masson, legal resources can be mobilized by some firms at any given moment. These **strong command corporations** are, by and large, financially healthy. At least in theory, they are more prone to leverage on legal costs as a pressuring tactic to win and may even use the threat of legal proceedings as a negotiation tool[237]. Their deep pockets would also explain why they are also good targets for strategic claims such class action proceedings. Strong command corporations can also afford to use time to either overburden the opposing party with evidence and experts, or to reduce the value of the claim altogether with never-ending interlocutory motions. Alternatively, they can seek to reduce time in the enforcement of their rights by including penalty clauses in their contracts. Ultimately, they can engage in cost-benefit analyses when assessing whether they should comply with a particular national legislation. In all cases, these corporations have a strong command on the resources – money and time – invested in corporate legal strategy.

According to Masson, **average command corporations** still have the capacity to improve their legal resources through mid or long-term investment. Although he does not specify the

[236] Antoine Masson, "The Crucial Role of Legal Capability in the Realisation of Legal Strategies" in Masson & Shariff, "Legal Strategies", *supra* note 74 at 102 [Masson, "Legal Capability"].
[237] *Ibid.* at 110.

types of industry or firms that would fall in this category, he suggests that the internal organization of the company is often determinative of a corporation's capacity to engage its legal resources and transform them into effective legal strategies. To this effect, Masson notes that the internal mode of organization of a particular corporation "plays a crucial role in the implementation of any legal action"[238]. He identifies a number of enhancing factors from which he believes firms can deploy their existing legal resources and develop their internal capabilities in the long-term.

For example, regarding the influence that corporate structures can have on the firm's legal capability, Masson observes that cascading corporate structures can allow the creation of multiple entities, which in turn, can effectively shield the holding from certain legal attacks[239]. He also notes that some membership-based associations[240] are naturally "endowed with broader legal standing (...) which can be useful in the implementation of legal strategies"[241]. Mason also notes that the use of a non-governmental organization status – instead of a partnership or corporation structure – can be "more advantageous for lobbying strategies as it gives the impression of the pursuit of a general interest goal"[242]. Another enhancing factor considered by Masson – access to information and legal expertise of the company – presupposes that "information is the sine qua non condition of any strategy"[243] and that

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[238] *Ibid.* at 106.

[239] See particularly, Claude Champaud & Didier Danet, *Stratégies Judiciaires des Entreprises* (Paris, FR: Dalloz, 2005). Cited in Masson, "Legal Capability", *supra* note 236 at 107.

[240] Examples of membership-based associations may include lawyers' associations (barreaux, law societies), but also private international organizations such as the International Olympic Committee and the Federation Internationale de Football Association (FIFA).

[241] Masson, "Legal Capability", *supra* note 236 at 107.

[242] The author notes that "non-governmental organizations can be advisory members to international organizations such as the United Nations." See, *ibid.*

[243] *Ibid.*

"implementing a strategy implies an in-depth knowledge of positive law"[244]. From these assumptions, it follows that, as a general rule, the more a corporation invests its resources in legal knowledge, the more it will improve its own legal corporate strategy over the long run. Although the author does not provide concrete examples, he refers to the role played by professional associations in increasing a "company's awareness of the legal aspects of what is at stake"[245].

Another factor explored by Masson, namely the relationship with stakeholders and relational network, points to the fact that the "nature, scope and extent of a company's economic relationship with its various stakeholders can be crucial in that it can allow the company to transfer some legal costs to third parties, or at the very least, minimize them"[246]. He points to the classic example of corporations inserting arbitration provisions into consumer contracts with the intention to avoid massive class actions[247]. In other cases, he observes, firms may share legal resources such as expertise and even orchestrate artificial litigation with the objective of creating legal precedent[248]. The delegation of intellectual property enforcement to local authorities is another example.

Despite a corporation's inherent investment capacity or its willingness to invest resources for legal capacity improvement, Masson suggests that some elements of legal resources are difficult to improve. For instance, a weak command corporation may already enjoy a privileged legal position because of its inherent economic power[249], and thus little incentives to invest in

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[244] *Ibid.*

[245] *Ibid.* at 108.

[246] *Ibid.*

[247] See particularly, Mary J. Shariff, Marlene Pomrenke & Vivian Hilder, "Perspectives on Legal Strategy Through Alternative Dispute Resolution" in Masson & Shariff, *Legal Strategies, supra* note 74 at Chapter 9.

[248] Masson, "Legal Capability", *supra* note 236 at 108.

[249] *Ibid.* at 103.

its internal legal resources. Industries that would fall under this category typically include those requiring enormous amounts of initial investment and those in which high fixed costs tend to predominate[250]. Large-scale industries[251] and traditional utilities[252] are examples of inherently powerful corporations that can leverage their economic power to obtain advantageous conditions, without much investment of resources in their legal capability, and at the expense of weaker parties such as suppliers, sub-contractors, and consumers. The author warns, however, that the inherent privileged legal position of a corporation can, in turn, encourage national governments to intervene in order to protect weaker parties. These efforts can take the form of pro-consumer[253], price-fixing[254], public ownership[255], or exclusive-rights[256] legislation.

Further, Masson suggests the levels of mobility of production factors – capital and labour – may also restrict the corporation's ability to use its legal resources. For example, forum shopping strategies may become rather difficult to exploit whenever a corporation's economic activity is linked to customers and suppliers that are not mobile. Masson also observes that heavily regulated industries are "often the origin of legal strategies that seek to benefit from the complexity of the laws applicable to that sector of activity"[257]. This trend can be particularly

[250] Some authors refer to them as natural monopolies, although it is questionable whether these are. It must be noted that the government may decide to grant a natural monopoly through special legislation. This has largely been the case in the airline industry until the era of deregulation (1978).

[251] For example, aerospace, automobile, banking, chemicals, oil and gas, pharmaceuticals, steel, and transportation.

[252] For example, water, electricity, and telecommunications.

[253] For example, *Consumer Reporting Act*, R.S.O. 1990, c. C.33 (Ontario), *Consumer Protection Act*, R.S.Q. c. P-40.1 (Quebec).

[254] For example, rent controls related legislations.

[255] Examples include public utilities and transportation related legislations.

[256] For instance, intellectual property legislations.

[257] Masson, "Legal Capability", *supra* note 236 at 104.

observed in the airline industry where early economic deregulation subsequently led to more regulation[258].

Masson also suggests that a firm's legal capacity may vary depending on its economic weight. For example, he notes, while well-established blue-chip corporations have the capacity to reap the benefits of regulatory complexity, "the constant evolution of law can prevent small businesses from applying certain strategies because of the difficulty for them to manage the flow of legal information"[259]. It is worth noticing that corporate mammoths, on the other hand, can also become subject of increased regulatory constraints and public scrutiny. According to Masson, the size of the company may also prevent it from using certain types of legal strategies. For example, instead of pursuing aggressive strategies such as forum shopping or direct lobbying tactics, some Multinational Corporations (MNCs) will usually prefer strategies based on normative environment framing such as signing deals with local governments to finance research centres[260].

Towards the end of his article, Masson provides a list of factors that are likely to affect a corporation's decision to invest in its legal capability: (1) **The normative and economic environment** surrounding the industry in which the corporation evolves (i.e., government regulation, closeness to customers, internationalization, dominance of technical norms, and use of alternative dispute resolution mechanisms); (2) **The nature of the company's activities** (i.e., need for long term contractual relations, role of law in business plan: patent law for R&D companies and distribution law for franchises); (3) **The legal environment** (i.e., state of consumer and insurance law, local tort regimes); (4) **Current and past events** (i.e., media focus

[258] Paul S. Dempsey & Andrew R. Goetz, *Airline Deregulation and Laissez-Faire Mythology* (Westport, CT: Quorum Books, 1992).

[259] Masson, "Legal Capability", *supra* note 236 at 104.

[260] *Ibid.* at 105.

on a specific problem or spotlight regulation); and the (5) **Level of managerial awareness** (i.e., academic background or risk of personal liability incurred by senior managers)[261].

He makes it clear that the factors driving companies to invest in their legal capability must not be confused with the reasons pushing a corporation to take legal action. The first reason to initiate legal action is "generally done by comparing the economic and reputational costs and benefits of a judicial action, evaluating the merits of a particular legal regime, or even evaluating the benefits that might be drawn from strict legal compliance"[262]. The second reason determining whether or not a corporation is prone to legal action is the perception of law at senior management levels. For example, he explains, managers can approach the law as a means of defence, a mode of regulation, and/or a technique of management[263]. Internally, the law department can be considered by senior managers as a necessary cost to ensure legal compliance, or as a strategic investment contributing to the corporation's strategic growth plan[264].

[261] *Ibid.* at 111-113.

[262] *Ibid.* at 113.

[263] See Pascal Philippart, "Proposition d'une approche de la gestion juridique en termes de marge: Caractéristiques et implications" (2000) Working Paper, CLAREE-IAE Lille Juin 2000, online: Université des Sciences et Technologies de Lille, <http://www.univ-lille1.fr/bustl-grisemine/pdf/rapports/G2000-173.pdf> (Last accessed: October 4, 2010).

[264] See particularly, Jean Paillusseau, "L'avenir du juriste d'affaires" (4 march 1994) 27 Revue de l'A.C.E. (Avocats Conseils d'Entreprise) 41.

Strategic Alliances: Legal Resource Complementarity and Sustained Competitive Advantage

I. Competitive Advantage and Firm Resources

The main objective of a firm's corporate strategy is to achieve a position of advantage in relation to other competitors. In **Chapter 2** of this thesis, several authors posited that the alignment of legal resources and corporate strategies within the firm would result in competitive advantage. Others argued that the effective management of nonmarket factors – through sound political and legal strategies – would improve the firm's performance, as well as its competitive positioning. Baron defended the view that nonmarket strategies can create value by improving a firm's overall performance; for example, when firms succeed in setting the pace and content of foreign trade policy[265]. Vining, Shapiro and Borges (VSB) and De Figuereido suggested that politically active firms can alter the competitive landscape to their advantage[266]. Finally, Roquilly contended that a proactive approach to risks and opportunities emerging from the legal sphere can protect a firm's competitive edge[267].

As suggested by scholars in the law and management field, the law has become a strategic tool that firms can utilize according to pre-defined business objectives and with the aim of

[265] Baron, "Integrated Strategy", *supra* note 32.

[266] Vining *et al.*, "Lobbying Strategy", *supra* note 22.

[267] Roquilly, "Legal Core Competency", *supra* note 70.

attaining sustained competitive advantage. Bagley, for example, proposes a theory of legal astuteness based on the resource-based view of the firm[268]. According to her, legally astute management teams – comprised of managers and their lawyers – can provide the firm with the ability to adapt and to innovate in light of changing external conditions. Above all, she contends that legal astuteness can only become a distinctive capability if it is valuable, rare, inimitable, and nonsubstitutable. She is of the view that firms who fail to integrate law into the formulation and implementation of core business strategy may find themselves at competitive disadvantage down the road.

Masson and Shariff et al. demonstrated great interest in exploring how legal resources can be mobilized, allocated, and optimized within firms seeking to improve their competitive position[269]. To that effect, Roquilly suggests that only an optimal combination of legal resources, capabilities and core competencies can help firms achieve their performance and positioning objectives[270]. In particular, he insists on the accumulation of property-based resources such as contracts, corporate structures, and intellectual property rights. In their article, LoPucki and Weyrauch argue that firm resources, especially financial and technical, can determine legal outcomes: "resources matter because they unleash strategy and strategy is capable of altering legal outcomes across a wide range of possibilities"[271]. They assume, in a way, that wealthier firms have more resources at their disposal, thus a greater capacity to "unleash" legal strategies whenever needed. Neither Roquilly nor LoPucki and Weyrauch discuss the role of lawyers and managers in developing or designing legal resources.

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[268] Bagley, "Legal Astuteness", *supra* note 73.

[269] Masson, "Legal Capability", *supra* note 236.

[270] Roquilly, "Legal Core Competency", *supra* note 70.

[271] LoPucki & Weyrauch, "A Theory of Legal Strategy", *supra* note 202 at 84.

Masson identifies a number of "enhancing factors" that are likely to help legally astute managers and lawyers deploy their firm's legal resources. These factors include complex corporate structures, access to information and legal expertise, as well as the firm's immediate relational network – or nonmarket environment. He notes, for example, that some firms may use membership-based associations in order to optimize and deploy their legal resources. Although he does not elaborate further on this point, he seems to recommend that firms create strategic alliances with external entities to optimize the deployment of legal resources. Under his theory, one can posit that "strong command – and wealthy –corporations" may decide to delegate the deployment, allocation, and optimization of legal resources to strategic partners.

As demonstrated above, the question of competitive advantage is undoubtedly a central feature of theories of legal astuteness, corporate political action and nonmarket strategies. Most authors consider that legal and political astuteness – including the firm's resources that allow such distinctive features to develop – are sources of competitive advantage. In light of this, and for conceptual reasons, this thesis contends that the time has come to conduct a systematic study of three important concepts widely used in the above-discussed literature: (1) firm resources, (2) competitive advantage, and (3) sustained competitive advantage.

Borrowing from the resource-based view of the firm proposed by Barney and the literature on resource complementarity, this chapter suggests that strategic alliances – formal and informal – can be excellent vehicles for legally astute teams seeking to institutionalize and maintain their firm's competitive position. As will be illustrated in Chapter 4, the development of effective legal risk management systems and the optimization of legal resources may need, in some cases, the establishment of strategic alliances based on resource complementarity. For example, legally astute firms – and their management teams – operating globally must consider

that the optimal deployment of legal resources can be facilitated by strategic alliances based on legal resource complementarities.

A. Traditional Approaches to Competitive Advantage

Central to the field of strategic management is the identification of sources of sustained competitive advantage. Mainstream theories of competitive analysis have usually focused on the link between firm strategy and the external environment. For example, in Michael E. Porter's theory, firms seeking to achieve competitive advantage in their respective industries are invited to implement market strategies based on a comprehensive evaluation of their internal strengths and weaknesses. This evaluation, Porter suggests, should always be accompanied by an assessment of the firm's external environment, namely external threats and current opportunities[272].

According to Barney, the environmental models of competitive advantage are based on two fallacious assumptions[273]. First, firms within a specific industry are identical in terms of the resources they control and the business strategies they pursue. Second, firms within industries possess homogenous resources and these resources can be easily exchanged, bought or sold. Amis, Pant and Slack contend, for example, that "the major limitation of the industry structure approach [proposed by Porter] is its central supposition that competitive advantage is conferred largely by [internal and external] factors which act upon the entire industry"[274]. Some authors suggest that Porter's approach overlooks the idiosyncratic competencies of firms and tend to

[272] Porter, *Competitive Strategy*, *supra* note 52.

[273] Barney, "Firm Resources", *supra* note 72 at 100.

[274] John Amis, Narayan Pant & Trevor Slack, "Achieving Sustainable Competitive Advantage: A Resource-based View of Sport Sponsorship" (1997) 11 Journal of Sport Management 80.

ignore the fact that these competencies can generate a sustainable competitive advantage[275]. As a matter of fact, Black and Boal have found that industry structure accounts only or 8% to 15% of the variance in firm performance[276]. Most studies surveyed for the purposes of this thesis agreed that "differences in profitability within industries are of much greater importance than differences between industries"[277].

B. Resource-Based View of the Firm

Contrary to the macro industry-centered approach adopted by traditional competitive analyses, the resource-based view of the firm examines the link between the firm's internal resources and overall performance. This approach is based on two important assumptions. First, firms within an industry are "heterogeneous with respect to the strategic resources they control"[278]. Second, the resources over which firms have control "are not perfectly mobile across firms, and thus heterogeneity can be long lasting"[279]. Hofer and Schendel have identified six categories of resources with the potential to generate sustained competitive advantage: (1) physical resources, (2) technological resources, (3) human resources, (4) financial resources, (5) organizational resources, and (6) reputational resources[280]. Barney proposes a somewhat different classification: (1) physical resources, (2) human resources, and (3) organizational

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[275] Augustine A. Lado, Nancy G. Boyd & Peter Wright, "A Competency-based Model of Sustainable Competitive Advantage: Toward a Conceptual Integration" (1992) 18 Journal of Management 77.

[276] Janice A. Black & Kimberley B. Boal, "Strategic Resources: Traits, Configurations, and Paths to Sustainable Competitive Advantage" (1994) 15 Strategic Management Journal 131.

[277] John M. Amis & T. Bettina Cornwell, eds. *Global Sport Sponsorship* (New York, NY: Berg Publishers, 2005) at 82 [Amis & Cornwell, *Global Sport Sponsorship*].

[278] Barney, "Firm Resources", *supra* note 72 at 101.

[279] *Ibid.*

[280] Charles W. Hofer & Dan Schendel, *Strategy Formulation: Analytical Concepts* (St. Paul, MN: West Publishing, 1978).

resources[281]. Amis et al. note that looking at the firm internal resources as foundational elements of sound strategic decision-making has created a renewed interest in the writings of economists such as David Ricardo, Joseph Schumpeter and Edith Penrose[282]. Above all, the resource-based view of the firm is based on the idea that sustained competitive advantage is directly determined by the firm's distinctive competencies. These competencies provide the firm with a competitive edge over its rivals.

1. Firm Resources

This thesis subscribes to the comprehensive definition of firm resources provided by the father of the resource-based view of the firm. In Barney's theory, firm resources include "all assets, capabilities, organizational processes, firm attributes, information, knowledge, etc. controlled by a firm that enable the firm to conceive and implement strategies that improve its efficiency and effectiveness"[283]. In the language of competitive analysis traditionalists, Barney notes, firm resources are internal assets that firms can use to conceive or implement their core business strategies.

According to Barney, a firm resource must possess four main attributes. First, it must be **valuable,** "in the sense that it exploits opportunities and/or neutralizes threats in a firm's environment"[284]. Second, it must be **rare** "among a firm's current and potential competition"[285].

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[281] Barney, "Firm Resources", *supra* note 72 at 101.

[282] Amis & Cornwell, *Global Sport Sponsorship*, *supra* note 277 at 82. See especially, David Ricardo, *Economic Essays* (New York, NY: A.M. Kelly, 1966); Joseph Schumpeter, *The Theory of Economic Development* (Cambridge, MA: Harvard University Press, 1934); Joseph Schumpeter, *Capitalism, Socialism, and Democracy*, 3rd ed., (New York, NY: Harper, 1950); Edith T. Penrose, *The Theory of the Growth of the Firm* (New York, NY: Wiley, 1958).

[283] Barney, "Firm Resources", *supra* note 72 at 101. See also Richard L. Daft, *Organizational Theory and Design* (New York, NY: West Publishers, 1983).

[284] Barney, *ibid.* at 105.

[285] *Ibid.* at 106.

Third, it must be **imperfectly imitable**, and fourth, it must be **nonsubstitutable**, namely, "there cannot be strategically equivalent substitutes for this resource that are valuable, but neither rare nor perfectly imitable"[286]. It is worth mentioning, at this point, that the four attributes proposed by Barney could potentially serve as empirical indicators to assess whether or not a particular firm – or strategic alliance – possesses the necessary legal resources to attain sustained competitive advantage.

Barney also suggests classifying firm resources into three categories[287]. **Physical capital resources** encompass all technology-based tools used in a firm, including plants and equipment, geographic location and access to raw resources. **Human capital resources** are typically intangible and may include "the training, experience, judgment, intelligence, relationships, and insight of individual managers and workers"[288]. **Organizational capital resources** cover formal reporting structures, formal and informal processes of planning, controlling and coordinating, and all those relations between a firm and its immediate nonmarket environment. Barney notes, however, that not all aspects of a firm's physical, human, and organizational capital resources may be relevant resources as some may even prevent the firm from formulating and implementing sound competitive strategies.

2. Competitive Advantage and Sustained Competitive Advantage

In Barney's theory, "a firm is said to have a **competitive advantage** when it is implementing a value-creating strategy *not simultaneously* being implemented by any current or potential

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[286] *Ibid.*

[287] See especially, Oliver E. Williamson, *Markets and Hierarchies* (New York, NY: Free Press, 1975); Gary S. Becker, *Human Capital* (New York, NY: Columbia University Press, 1964); John F. Tomer, *Organizational Capital: The Path to Higher Productivity and Well-Being* (New York, NY: Praeger, 1987).

[288] Barney, "Firm Resources", *supra* note 72 at 101.

competitors"[289]. Even better, a firm can achieve **sustained competitive advantage** when it implements "a value creating strategy *not simultaneously* being implemented by any current or potential competitors AND when these other firms are unable to duplicate the benefits of this strategy"[290]. Barney explains that sustained competitive advantage cannot be circumscribed to a particular period of time. Instead, it should be assessed on the criteria of competitive duplication: "a competitive advantage is sustained only if it continues to exist after efforts to duplicate that advantage has ceased (…)"[291]. In other words, it is not the period of calendar time that defines the existence of sustained competitive advantage, "but the inability of current and potential competitors to duplicate that strategy that makes a competitive advantage sustained"[292]. Finally, Barney recognizes that some external factors – like unanticipated systemic changes in the nature of the economy or structural changes within an industry – can alter the nature of what were once sources of sustained competitive advantage into irrelevant sources.

II. Attributes of Resources

According to Barney's theory, resources with the potential to provide sustainable competitive advantage to the firm must possess, at least, four attributes – or empirical indicators. It will be important to keep these indicators in mind when the studies are presented in Chapter 4 and Chapter 5 of this thesis.

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[289] *Ibid.* at 102.

[290] *Ibid.*

[291] *Ibid.*

[292] *Ibid.* at 103.

A. Valuable

Resources are said to be valuable when they enable the firm to formulate or implement strategies – market or nonmarket, legal or political – that allow for an overall improvement of its performance in efficiency and effectiveness terms. Barney notes that there is an important complementarity between traditional models of competitive analysis and the theoretical model he proposes. Traditional models permit the isolation of strengths, weaknesses, threats, and opportunities in order to determine a firm's competitive advantage. The resource-based view looks at what additional characteristics – presumably internal – the firm must possess in order to create a sustained competitive advantage[293].

B. Rare

As explained above, firms can achieve sustained a competitive advantage when they implement value-creating strategies *not simultaneously* being implemented by any current or potential competitors, *and* when these other firms are unable to duplicate the benefits of this strategy[294]. Consequently, the rarity of resources available to the firm becomes a key attribute of corporate competitiveness. The underlying idea here is that competitors – or potential entrants – must not have easy access to a particular resource owned by the firm. In Barney's words, if a particular bundle of resources is not rare, "then large numbers of firms will be able to conceive of and implement the strategies in question, and these strategies will not be a source of competitive advantage, even though the resources in question may be valuable"[295]. Hambrick identifies managerial talent as one valuable and rare resource that firms may

[293] *Ibid.* at 106.

[294] *Ibid.* at 102.

[295] *Ibid.* at 106.

capitalize on in order to implement all strategies[296]. This aspect will be particularly discussed in Chapter 5 of this thesis.

Finally, borrowing from price theories[297], Barney contends that the rule of thumb to evaluate whether a resource can be qualified as rare is counting the number of firms that currently possess that resource or bundle of resources and make sure that the number is less than the number of firms necessary to create perfect competition in a particular industry.

C. Imperfectly Imitable

Getting closer to the heart of his theory, Barney contends that "valuable and rare organizational resources can only be sources of competitiveness if firms that do not possess these resources cannot obtain them"[298]. According to the author, resources can only be imperfectly imitable when they appear under one or a combination of the three following situations. First, when the ability of the firm to obtain the resource emerges from particular historical conditions. Historically relevant factors include the timing of a firm's founding, and the circumstances under which senior management teams take over a firm. Barney notes that "the literature in strategic management is littered with examples of firms whose unique historical position endowed them with resources that are not controlled by competing firms and that cannot be imitated"[299].

The second situation is when there exists causality ambiguity between the resources possessed by a firm and that firm's sustained competitive advantage. In other words, when the

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[296] See Donald C. Hambrick, "Top Management Teams: Key to Strategic Success" (1987) 30 California Management Review 88 [Hambrick, "Top Management Teams"].

[297] See particularly, Jack Hirshleifer, *Price Theory and Applications*, 2nd ed. (Englewood Cliffs, NJ: Prentice-Hall, 1980).

[298] Barney, "Firm Resources", *supra* note 72 at 107.

[299] *Ibid.* at 108.

link between the resources controlled by the firm and the same firm's sustainable competitive advantage are not well understood by its competitors. Barney warns, however, that "in order for causal ambiguity to be a source of sustained competitive advantage, all competing firms must have an imperfect understanding of the link between the resources controlled by a firm and the firm's inherent competitive advantage.

The third situation proposed by Barney relates to the inherent social complexity of the resources presumably providing a sustained competitive advantage to the firm. Some examples identified in the current literature include a firm's culture[300], a firm's reputation among suppliers and customers[301], and the interpersonal relations among managers of the firm[302]. Complex information management systems would not be considered socially complex phenomena for the purposes of Barney's theory.

D. Nonsubstitutable

In Barney's words, "the last requirement for a firm resource to be a source of sustained competitive advantage is that there must be no strategically equivalent valuable resources that are themselves either not rare or imitable"[303]. In particular, substitutable resources can take two forms. For example, in cases where firms are unable to imitate a resource or bundle of resources controlled by a competitor, they may attempt to substitute them by a similar resource that produces the same results, or at least that allows the firm to implement the same strategies

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[300] Jay B. Barney, "Organizational Culture: Can It Be a Source of Sustained Competitive Advantage?" (1986) 42 Academy of Management Review 656.

[301] Benjamin Klein, Robert G. Crawford & Armen A. Alchian, "Vertical Integration, Appropriable Rents, and the Competitive Contracting Process" (1978) 21 Journal of Law and Economics 297. See also, Benjamin Klein & Keith B. Leffler, "The Role of Price in Guaranteeing Quality" (1981) 89 Journal of Political Economy 615.

[302] Hambrick, "Top Management Teams", *supra* note 296.

[303] Barney, "Firm Resources", *supra* note 72 at 111.

generating sustained competitive advantage. In other cases, different firm resources can be strategic substitutes. Barney cites the example of senior management teams having a clear vision of the future of the firm. In one firm, sustainable competitive advantage may be attained because of a charismatic leader[304]. In another firm, the same objective may be obtained by a clear common vision from a team of managers in tune with the firm's planning processes[305]. In both cases, the resources are strategically equivalent and thus substitutes for one another. Barney also explains that substitutability of firm resources is a question of degree. For example, substitute firm resources may not have the same implications for all firms.

In sum, according to Barney's theory, "if enough firms have valuable substitute resources (i.e., they are not rare), or if enough firms can acquire them (i.e., they are imitable), then none of these firms (including firms whose resources are being substituted for) can expect to obtain a sustained competitive advantage"[306].

III. Resource Complementarity

Bagley, Roquilly, Masson, and Barney all agree that firm resources, and especially legal resources, can be important sources of sustained competitive advantage. They neglect, however, to point out that firms seldom possess all the necessary resources – physical, human, and organizational – to improve their competitive position[307]. They generally assume that firm

[304] See Lynne G. Zucker, "The Role of Institutionalization in Cultural Persistence" (1977) 421 American Sociological Review 726.

[305] See John A. Pearce, Elizabeth B. Freeman & Richard B. Robinson, "The Tenuous Link Between Formal Strategic Planning and Financial Performance" (1987) 12 Academy of Management Review 658.

[306] Barney, "Firm Resources", *supra* note 72 at 112.

[307] See John Child & David Faulkner, *Strategies of Cooperation: Managing Alliances, Networks, and Joint Ventures* (Oxford, UK: Oxford University Press, 1998). See also, Jeffrey H. Dyer & Harbir Singh, "The Relational View:

resources are only to be found inside the firm. In doing so, they fail to recognize that cooperative arrangements – i.e., strategic alliances – can accelerate the accumulation, deployment and optimization of legal resources[308].

This thesis contends that strategic alliances can be excellent vehicles for legally astute teams seeking to institutionalize and maintain their firm's competitive position. As will be illustrated in Chapter 4, the development of effective legal risk management systems and the optimization of legal resources may need, in some cases, the establishment of international strategic alliances based on resource complementarity. These strategic alliances can produce effective governance structures, which in turn can become attractive means for firms seeking to: (1) enhance their internal resources, (2) decrease various transaction costs, (3) increase strategic flexibility, and most importantly, (4) reduce legal risks[309].

Several studies confirm that strategic alliances based on resource complementarity can generate the potential for increasing firm performance in the long run. This "valuable, unique, and inimitable synergy that can be realized by integrating complementary resources provides an opportunity for the firm to create competitive advantages that can be sustained for a period of time"[310]. This trend is strongly supported by empirical evidence. In the last decade of the

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Cooperative Strategy and Sources of Interorganizational Competitive Advantage" (1998) 23 Academy of Management Review 660; Pfeffer & Salancik, *The External Control of Organizations, supra* note 150.

[308] See especially, Shaker A. Zahra *et al.*, "Privatization and Entrepreneurial Transformation: Emerging Issues and a Future Research Agenda" (2000) 25 Academy of Management Review 509.

[309] See Robert E. Hoskisson & Lowell W. Busenitz, "Market Uncertainty and Learning Distance in Corporate Entrepreneurship Entry Mode Choice" in Michael A. Hitt *et al.*, eds., *Strategic Entrepreneurship: Creating a New Integrated Mindset* (Oxford, UK: Blackwell Publishers, 2001). See also Michael A. Hitt, Baibaia W. Keats & Samuel M. DeMarie, "Navigating in the New Competitive Landscape: Building Strategic Flexibility and Competitive Advantage in the 21st Century" (1998) 12:4 Academy of Management Executive 22.

[310] Jeffrey S. Harrison *et al.*, "Resource Complementarity in Business Combinations: Extending the Logic to Organizational Alliances" (2001) 27 Journal of Management 679.

second millennium, the use of alliances increased by 25% per year[311]. The valuable, unique, and inimitable synergy attained through strategic alliances certainly echoes Barney's resource-based view of the firm and Bagley's proposed approaches to legal astuteness. As will be discussed in Chapter 4, and to a lesser extent in Chapter 5, legally astute firms have managed to achieve sustained competitive advantage by entering into governance arrangements based on legal resource complementarity. These arrangements are often specific to the organizations and institutions involved, and can only be achieved if legally astute managers work with their lawyers to combine the right legal instruments.

[311] See John R. Harbison & Peter Pekar Jr., *Smart Alliances* (San Francisco, CA: Jossey-Bass Publishers, 1998).

Legal Astuteness and Resource Complementarity: The Case of Olympic Sponsors

This chapter presents a case study of global sport sponsorships. Broadly put, the study analyzes the legal and institutional aspects behind the commercialization of the Olympic brand, including the protection of the Olympic symbols. In doing so, it seeks to unveil the governance structure that supports the ongoing commercial relationship between the Olympic family and its corporate sponsors. The study essentially contends that the strategic alliance between global sponsors and the International Olympic Committee (IOC) is a source of sustained competitive advantage. The valuable, unique, and inimitable synergy created by this alliance has permitted the effective management of various legal risks associated with sport sponsorship contracts. For example, the imitation or partial appropriation of trademarks, ambush marketing campaigns, and counterfeiting. Finally, this study suggests that strategic alliances based on resource complementarity can be excellent vehicles for legally astute teams seeking to institutionalize and maintain their firm's competitive advantage.

Part I will provide an overview of the global sponsorship industry, in particular the methods and means used by managers to determine the commercial potential of sports sponsorship arrangements. The commercial rationale behind Olympic sports sponsorship from a global firm perspective will also be discussed. **Part II** will present some historical and institutional aspects of the Olympic Movement (OM), including the legal nature and powers of

the International Olympic Committee (IOC), the National Olympic Committees (NOCs), and the central role of the Organizing Committee of the Games (OCOG). **Part III** will analyze the various legal mechanisms – or legal resources – provided by the IOC to its corporate sponsors. Particular attention will be devoted to the advertising and marketing-related provisions in the Olympic Charter, the Olympic Host City Contract, and the Technical Manual on Brand Protection.

I. The Sports Sponsorship Industry

In recent years, global firms have come to recognize the value of sponsorships as a marketing communication tool. For some, sponsorship has become the optimal positioning tool for multinational firms seeking to communicate global messages[312]. Some even suggest that sponsorship has the marketing potential to surpass television as the dominant medium for corporate promotion[313]. Today, senior marketing managers are faced with the difficult task of differentiating their firms from other global competitors while, at the same time, having to overcome the inherent advantages of locally established firms[314]. Adidas is particularly well-known for its global-local market dialectic. The company typically moves to address "global niches through athletes who may be global idols [David Beckham], local luminaries [Ian Thorpe], or foreign enigmas [Jonah Lomu]"[315].

[312] Francis Farrelly &Pascal Quester, "In the Name of the Game" (1997) 5:1 Asia-Australia Marketing Journal 5.

[313] M. Phillips, "Does Sponsorship Pay?" *Marketing* (Australia) (July 1994) at 12-17.

[314] Amis & Cornwell, *Global Sport Sponsorship*, *supra* note 277 at 6.

[315] Andrew D. Grainger, Joshua I. Newman & David L. Andrews, "Global Adidas: Sport, Celebrity and the Marketing of Difference" in Amis & Cornwell, *Global Sport Sponsorship*, *supra* note 277 at 93.

A. Sponsorship Agreements: Strategic Positioning and Decision-Making Process

As expenditures in the sports sponsorship industry have increased, senior marketing executives have started to consider whether sport sponsorships occupy a central role in the strategic positioning of their firm and its branding strategies[316]. From an organizational point of view, sport sponsorships are at the crossroads between strategic and operational marketing strategies, and "the perceived value of a sponsorship offer depends on how well it contributes to the success of its own marketing strategy"[317]. Sports sponsorship can be defined as a "commercial agreement by which a sponsor contractually provides financing or other support in order to establish an association between the sponsor's image, brands or products and a sports property/event in return for rights to promote this association and/or for granting certain agreed direct or indirect benefits"[318]. Tripodi suggests that sponsorship is essentially a brand equity-building strategy "which is used to position the brand so the value of the brand's image is enhanced, thus its perceived superiority over competitors is established"[319].

The methods and means for strategic-decision making are generally based on a comprehensive assessment of the firms' strengths, weaknesses, opportunities, and threats (SWOT analysis). In the context of sport sponsorships, the SWOT analysis must absolutely

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[316] See particularly, David M. Carter, *Keeping Score: An Inside Look at Sports Marketing* (Grants Pass, OR: Oasis Press/PSI Research, 1996); David Gilbert, "Sponsorship Strategy Is Adrift" (1988) 14 The Quarterly Review of Marketing 6. See also, Ton Otker, "Exploitation: The Key to Sponsorship Research" (1988) 16:2 European Research 77.

[317] Alain Ferrand, Luiggino Torrigiani & Andreu Camps i Povill, *Routledge Handbook of Sports Sponsorship: Successful Strategies* (Abingdon, UK: Routledge, 2007) at 85 [Ferrand *et al.*, *Handbook of Sport Sponsorship*].

[318] Sten Soderman & Harald Dolles, "Strategic Fit in International Sponsorship – The Case of the Olympic Games in Beijing 2008" (2008) International Journal of Sports Marketing and Sponsorship 95 at 97.

[319] John A. Tripodi, "Sponsorship – A Confirmed Weapon in the Promotional Armoury" (2001) International Journal of Sports Marketing & Sponsorship 95 at 101.

include an analysis of the internal and external sponsorship environment[320]. The **external analysis** is based on the environment in which the event owner and the firm sponsor will operate. It includes a variety of quantitative and qualitative analyses based on market, consumer and competitor measures[321]. Particularly relevant to this thesis is the analysis of environmental factors such as the legal framework and local business conditions. Ferrand, Torrigiani and Camps i Povilli explain that "a careful analysis of any change at the legislative level should be examined with a view to determine how it can affect the sponsorship operation"[322]. The **internal analysis** focuses on the available resources and competencies of the event owner. It involves, for example, identifying the overarching mission of the event owner. It also includes a qualitative assessment of resource management systems (i.e., systems of control and reward) and available physical resources (i.e., locations, facilities, and installations).

B. Commercial Rationale of Olympic Sponsorship

Firms invest in sponsorship initiatives to promote their communication objectives of brand awareness and to increase the value of their corporate/brand image[323]. Olympic sponsors

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[320] Ferrand *et al.*, *Handbook of Sport Sponsorship*, *supra* note 317 at 86.

[321] The external analysis must include: (1) a market research based on the size, dynamics, entry barriers, and key factors of success; (2) an analysis of segmentation, expectations, and unsatisfied needs of potential consumers and customers; and (3) a competitor analysis focusing on the strategies, performance, objectives, strengths and weaknesses of direct and indirect competitors. See David A. Aaker, *Strategic Market Management* (Hoboken, NJ: John Wiley, 2001).

[322] Ferrand *et al.*, *Handbook of Sport Sponsorship*, *supra* note 317 at 88.

[323] See especially, Richard L. Irwin & Makis K. Asimakopoulos, "An Approach to the Evaluation and Selection of Sport Sponsorship Proposals" (1992) 1:2 Sport Marketing Quarterly 43. The authors divide sponsorship objectives in two categories: (1) **Corporation-related objectives** (increase public awareness of the company and its services, enhance company image, alter public perception, increase community involvement, build business/trade relations and goodwill, and enhance staff/employees' relations and motivation); (2) **product/brand-related objectives** (increase target market awareness, identify/build image within target market or positioning, increase sales and market share, and block/pre-empt competition). See also, Richard L. Irwin & William A. Sutton, "Sport Sponsorship

usually contribute an average of $80-100 million dollars per product category in order to secure four-year exclusive rights to two Olympic Games, both winter and summer, as well as rights to sponsor National Olympic Committees (NOCs). In addition to worldwide exclusive rights and brand presence in emerging markets, Olympic sponsors also expect to participate in a large number of public relations and promotional activities, and to obtain easy access to tickets and hospitality events[324]. In terms of value-creation, the Olympic Movement has the potential to reinforce stronger sponsor brand, to increase revenues beyond local markets, and to transcend the fans' community[325]. It is worth noticing that the Olympic sponsorship does not seem to attract industries in which natural resources and monopoly status are the core capacity of the firms (i.e., oil & gas, utilities). As evidenced by the current list of sponsors[326], the Olympic sponsorship programme attracts global, multi-domestic industries where brand equity is a determinant of market power and profits.

II. Legal and Institutional Aspects of the Olympic Movement

The Olympic Movement (OM) has undergone profound institutional changes since the re-establishment of the Olympic Games in 1896 by French visionary Baron Pierre de Coubertin. In

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Objectives: An Analysis of their Relative Importance for Major Corporate Sponsors" (1994) 1:2 European Journal for Sport Management 93.

[324] Chrysostomos Giannoulakis, David Stotlar & Dikaia Chatziefstathiou, "Olympic Sponsorship: Evolution, Challenges, and Impact on the Olympic Movement" (2008) 9:4 Int'l Journal of Sports Marketing & Sponsorship 256 at 259.

[325] John Fahy, Francis Farrelly & Pascal Quester, "Competitive Advantages through Sponsorship – A Conceptual Model and Research Propositions" (2004) 38:8 European Journal of Marketing 1013.

[326] These are the TOP sponsors for the London 2012 Summer Olympic Games: COCA-COLA, ACER, ATOS ORIGIN, DOW, GE, McDONALD'S, OMEGA, PANASONIC, P&G, SAMSUNG, and VISA. According to the IOC, the Olympic Partner (TOP) programme is the highest level of Olympic sponsorship and provides sponsors with exclusive worldwide marketing rights to both the Summer and Winter Games. Online at: <http://www.olympic.org/en/content/The-IOC/Sponsoring/Sponsorship/?Tab=1> (Last Accessed: December 15, 2010).

recent years, the internationalization and commercialization of the Olympic Games have prompted the OM to create a legal structure that governs its organization, actions and operations, and sets forth the conditions for the celebration of the Olympic Games. As will be discussed in **Part III**, the legal structure and mechanisms provided by the OM have facilitated the creation of a strategic alliance with corporate sponsors. The unique, rare, inimitable and nonsubstitutable nature of this alliance gave birth to the most effective and competitive brand management programs in the world.

A. The Olympic Movement

Membership to the Olympic Movement (OM) is, by definition, voluntary. Under the supreme authority of the International Olympic Committee (IOC), the Olympic Movement (OM) comprises all those organizations, athletes, and persons who agree to be guided by the Olympic Charter, the Lex maxima of Olympism[327]. Compliance with the Olympic Charter and recognition by the IOC, however, are not optional. The Sixth Fundamental Principle of Olympism states that: "Belonging to the Olympic Movement requires compliance with the Olympic Charter and recognition by the IOC"[328]. Furthermore, Rule 1(2) of the Olympic Charter provides that: "Any person or organisation belonging in any capacity whatsoever to the Olympic Movement is bound by the provisions of the Olympic Charter and shall abide by the

[327] International Olympic Committee (IOC), *Olympic Charter*, in force as from 11 February 2010 (Lausanne, SZ: International Olympic Committee, 2010), online at: <www.olympic.org> (Last accessed: December 1, 2010) at Rule 1 (1) [*Charter*]. See also in *Charter*, at 9, *Introduction to the Olympic Charter* ("The Olympic Charter, as a basic instrument of a constitutional nature, sets forth and recalls the Fundamental Principles and essential values of Olympism, (...) serves as statutes for the International Olympic Committee, (...) defines the main reciprocal rights and obligations of the three main constituents of the Olympic Movement, namely the International Olympic Committee, the International Federations, and the National Olympic Committees, as well as the Organising Committees for the Olympic Games, all of which are required to comply with the Olympic Charter") [emphasis added].

[328] See *Charter*, *supra* note 327 at 11 (*Fundamental Principles of Olympism*). See also Rule 3(1) and (2) at 16.

decisions of the IOC"[329]. It is worth noticing that "the authority of last resort on any question concerning the Olympic Games rests with the IOC"[330].

The most important constituents of the OM are the **International Olympic Committee (IOC)**, the **International Sports Federations (IFs)**, and the **National Olympic Committees (NOCs)**[331]. The OM also encompasses the **Organizing Committees of the Olympic Games (OCOGs)**, including "the national associations, clubs and persons belonging to the IFs and NOCs (...) as well as the judges, referees, coaches and the other sports officials and technicians"[332]. What follows is a brief review of the legal status, inherent powers, and responsibilities of each constituent.

1. The International Olympic Committee (IOC)

The legal status of the IOC has been historically confronted "with the contradiction between its legally recognised status as a private law association and its current conduct as a particular type of public law organisation"[333]. As noted by Gilliéron, Pierre de Coubertin initially wanted to place the IOC on an equal footing with other international organizations[334]. The legal ambivalence associated with the IOC, however, was recently clarified in the Olympic Charter (OC). Rule 15(1) of the OC defines the IOC as "an international non-governmental not-for-profit organization, of unlimited duration, in the form of an association with the status

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[329] *Ibid.* at Rule 1(2).

[330] *Ibid.* at Rule 6(3).

[331] *Ibid.* at Rule 1(2).

[332] *Ibid.* at Rule 1(3).

[333] Alexandre Miguel Mestre, *The Law of the Olympic Games* (West Nyack, NY: Cambridge University Press, 2009) at 38 [Mestre, *Olympic Games*].

[334] Christian Gilliéron, *Les relations de Lausanne et du Mouvement Olympique à l'époque de Pierre de Coubertin 1894-1939* (Lausanne, SZ: IOC, 1993) at 92-93.

of a legal person"[335]. It must be noted that the decisions of the IOC are binding and final[336], and any disputes relating to the application or interpretation of the Charter "may be resolved solely by the IOC Executive Board (…)"[337]. Furthermore, the powers of the IOC are exclusively exercised by three organs: **the Session**, the **IOC Executive Board**, and the **President**[338].

The Session is formed by Members of the IOC and can be considered the IOC's supreme legislative organ[339]. It can adopt or amend the Olympic Charter and it has the power to elect the host city of the Olympic Games[340]. The IOC Executive Board "assumes the general overall responsibility for the administration of the IOC and the management of its affairs"[341]. In particular, the IOC Executive Board monitors the observance of the Olympic Charter and is responsible for approving all internal governance regulations relating to its organization[342]. It also issues all regulations of the IOC such as "codes, rulings, norms, guidelines, guides, manuals, instructions, requirements, and other decisions, including (…) all regulations necessary to ensure the proper (…) organisation of the Olympic Games"[343]. The Session elects the President, by secret ballot, among its Members[344].

2. The National Olympic Committees (NOCs)

The roots of the National Olympic Committees (NOCs) can be found in the 1894 edition of an IOC Bulletin: "each country shall create a NOC with the task of ensuring the participation of

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[335] *Charter*, *supra* note 327, at Rule 15(1).
[336] *Ibid.* at Rule 15(4).
[337] *Ibid.*
[338] *Ibid.* at Rules 17(1)(2)(3).
[339] *Ibid.* at Rule 18(1).
[340] *Ibid.* at Rules 18(2) 2.1, 2.4.
[341] *Ibid.* at Rule 19(3).
[342] *Ibid.* at Rules 19(3) 3.1, 3.2.
[343] *Ibid.* at Rules 19(3) 3.10.
[344] *Ibid.* at Rule 20(1).

that country in the Olympic Games every four years"[345]. Today, the overall mission of NOCs is more comprehensive but their area of jurisdiction remains bound by geographical limits[346]: "The mission of the NOCs is to develop, promote, and protect the Olympic Movement in their respective countries, in accordance with the Olympic Charter"[347]. The NOCs have also the exclusive authority for the representation of their countries in all competitions "patronised by the OIC", including the Olympic Games[348].

Regarding the organization of the Olympic Games, the NOCs retain exclusive authority "to select and designate the city which may apply to organise [them] in their respective countries"[349]. Additionally, the NOCs are invited to "cooperate" with governmental bodies[350]. The IOC provides the NOCs with operational assistance through its various departments[351].

3. The Organizing Committees of the Olympic Games (OCOGs)

By virtue of the Olympic Charter, the OCOGs are established by the NOCs once the election of the host city is announced by the President of the IOC[352]. The OCOG "shall have the status of a legal person in its country"[353] and "from the time it is constituted, reports directly to the IOC Executive Board"[354]. It is worth noticing that the organization of the Olympic Games is

[345] Mestre, *Olympic Games*, *supra* note 333 at 44.
[346] *Charter*, *supra* note 327 at Rule 29(5).
[347] *Ibid.* at Rule 28(1).
[348] *Ibid.* at Rule 28(3).
[349] *Ibid.* at Rule 28(4).
[350] *Ibid.*
[351] *Ibid.* at Rule 28(8).
[352] *Ibid.* at Rule 36. See also Bye-law to Rule 34, Art. 3.
[353] *Ibid.* at Bye-law to Rule 36, Art. 1.
[354] *Ibid.* at Rule 36.

"entrusted by the IOC to the NOC of the country of the host city as well as to the host city itself"[355].

III. Resource Complementarity: A Key Element of Legal Astuteness

Based on the resource-based view of the firm discussed in **Chapter 2** and **Chapter 3**, sustained competitive advantage can be achieved only if a firm possesses distinctive (i.e., unique, rare, inimitable, and nonsubstitutable) legal resources and is willing or capable to deploy them in order to acquire distinctive legal competencies[356]. This thesis contends that distinctive legal resources are not exclusively found within firms. These distinctive resources can be obtained through cooperative arrangements with other firms. In the case of Olympic sponsorships, corporate sponsors were looking for a way to increase their brand equity globally. However, they also sought to minimize the legal risks associated with global sponsorship contracts such as poor enforcement levels of trademark rights in foreign countries.

At the same time, the OIC had decided to diversify its revenue-generating strategies. Until the 80s, it must be noted that the Olympic Movement derived most of its revenue from the sale of television rights. The exploitation of the Olympic symbols through bullet-proofed sponsorship contracts made sense from a commercial point of view. Over the years, the IOC developed a very sophisticated legal structure to support its sponsorship deals. The following sections will analyze the most important legal mechanisms that have contributed to the success of the Olympic sponsorship program. The strategic alliance between the IOC and corporate

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[355] *Ibid.*

[356] Barney, "Firm Resources", *supra* note 72; Masson, "Legal Capability", *supra* note 236; Bagley, "Legal Astuteness", *supra* note 73; Roquilly, "Legal Core Competency", *supra* note 70; LoPucki & Weyrauch, "A Theory of Legal Strategy", *supra* note 202.

sponsors is certainly illustrative of how firms may combine resources to achieve sustained competitive advantage and keep external threats – i.e., competitors – at bay.

1. The Olympic Charter

The Olympic Charter can be considered the legal foundation of the governance structure that supports the Olympic sponsorship programme, also known as the Olympic Partner (TOP) Programme. For instance, the Charter recognizes the IOC's exclusive rights over the Olympic Games and Olympic Properties. Rule 7(1) of the Charter states that: "The Olympic Games are the exclusive property of the OIC which owns all rights and data relating thereto, in particular, and without limitation, all rights relating to the organisation, exploitation, broadcasting, recording, representation, reproduction, access and dissemination (…)"[357]. More importantly, Rule 7(2) allows the IOC to negotiate and license all or part of its rights over the so-called Olympic properties, namely "the Olympic symbol, flag, motto, anthem, identifications, designations, emblems, flame and torches"[358]. Further, Rule 7(2) of the Charter provides that: "All rights to any and all Olympic properties, as well as all rights to the use thereof, belong exclusively to the IOC, including but not limited to the use for any profit-making, commercial, or advertising purposes"[359]. Clearly, the IOC possesses the legal standing and necessary powers to manage sponsorship-related initiatives and projects.

The Olympic Charter also clarifies the legal responsibilities of parties involved in the TOP Programme. For example, the IOC is responsible for the legal protection of the rights it has over the Olympic Games and over any Olympic property[360]. The NOC is, in principle, responsible to

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[357] *Charter*, *supra* note 327 at Rule 7(1).

[358] *Ibid.* at Rule 7(2).

[359] *Ibid.*

[360] *Ibid.* at Bye-law to Rules 7-14, 1(1.1).

the OIC for the respect of the Olympic properties. However, it may obtain technical assistance from the IOC at any time if needed, especially if the requested assistance concerns either the protection of any Olympic property or the settlement of differences with third parties[361]. Furthermore, Rule 37 establishes the rules applicable to cases of non-compliance with the Olympic Charter, including any breach of the obligations entered into by the NOC, the OCOG, or the host city[362]. Rule 37 (1) states that: "The NOC, the OCOG and the host city are jointly and severally liable for all commitments entered individually or collectively concerning the organisation and staging of the Olympic Games". Rule 37 (2) reminds parties that sanctions for non-compliance with the Charter may lead to withdrawal of the organisation of the Olympic Games "without prejudice to compensation for any damage"[363].

By virtue of Rule 34 (3), the Charter bullet-proofs the various undertakes and guarantees provided by the host city in the Host City Contract: "The National Government of the country of any applicant city must submit to the IOC a legally binding instrument by which the said government undertakes and guarantees that the country and its public authorities will comply with and respect the Olympic Charter"[364]. This provision is important for two reasons. First, it forces national governments to cooperate with the OCOG regarding the adoption of special legislation to prevent ambush marketing practices. Second, it legitimizes the involvement of national governments in the protection of private commercial interests. In light of this, it becomes clear that the governance structure also requires the formulation and implementation

[361] *Ibid.* at Bye-law to Rules 7-14, 1(1.4).

[362] *Ibid.* at Rule 37(2).

[363] *Ibid.* at Rule 37(2) also excludes all forms of compensation against the IOC coming from "the NOC, the OCOG, the host city, the country of the host city and all their governmental or other authorities, or any other party, whether at any city, local, state, provincial, other regional or national level."

[364] *Ibid.* at Rule 34(3).

of lobbying activities, thus delegating corporate political action to the NOC and OCOG respectively. The ultimate responsibility to protect the Olympic brand remains with the OCOG.

2. The Host City Contract

This contract of adhesion must be signed by all bidding cities and it becomes executable immediately after the election of the Host City by the Session[365]. The Host City Contract (HCC) relies on the covenant given by the national government of the country in which the Host City and the NOC are situated[366]. It also refers to the undertaking of the Host City and the NOC to organize the Games in full compliance with the Olympic Charter[367]. More importantly, it requests the Host City, the NOC and the OCOG to ensure that the "Government, as well as their regional and local authorities, honour all commitments undertaken by the Government and such authorities in relation to the planning, organization and staging of the Games (…)"[368].

Section VII of the HCC deals with intellectual property-related matters. In particular, the IOC requires a guarantee from the Host City confirming that, prior to the commencement of the Olympic Games, special legislation will be passed in the Host Country[369]. Such legislation should effectively reduce and sanction ambush marketing practices. The OCOG must assess existing legislation and identify those areas where additional special legislation is necessary to fulfill the IOC's requirements. It must also work with the Government and/or competent

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[365] *Ibid.* at Bye-law to Rule 34, Article 3(3.3).

[366] *Ibid.* at Rule 34(3). See also, International Olympic Committee (IOC), *Host City Contract for the Games of the XXX Olympiad in 2012 (London)* (Lausanne, SZ: International Olympic Committee, July 5th 2005), online at: < http://www.gamesmonitor.org.uk/files/Host%20City%20Contract.pdf> (Last accessed: December 1, 2010) at paragraph G of the Preamble [IOC, *Host City Contract*].

[367] *Ibid.* at paragraph H of the Preamble.

[368] *Ibid.* at article 5.

[369] *Ibid.* at article 41(a)(b)(c)(d) and (e).

national authorities to ensure adequate levels of legal protection[370]. Section VII further provides that: "Actions in the Host Country with respect to unauthorized use of the properties relating to the Games, including trademark rights, shall be taken by the OCOG, at its expense, in consultation with the IOC"[371].

Regarding ambush marketing protection, the HCC reminds the Host City, the NOC and the OCOG about the importance to protect the rights granted to the Olympic sponsors. In particular, it requests them "to agree to take all necessary steps, at their cost, to prevent and/or terminate any ambush marketing or any unauthorized use of Olympic properties"[372]. According to the Technical Manual on Brand Protection, the term ambush marketing includes "all intentional and unintentional attempts to create a false or unauthorised commercial association with the Olympic Movement or the Olympic Games"[373]. Examples of ambush marketing practices are "(a) a non-partner company's use of creative means to generate a false association with the Olympic Games, (b) a non-partner company's infringement of the various laws that protect the use of Olympic imagery and indicia, and (c) a non-partner company's activities that intentionally or unintentionally interfere with the legitimate marketing activities of Olympic partners"[374]. Furthermore, prior to the commencement of the Games, the OCOG has the obligation to present the IOC with a detailed ambush marketing prevention plan, "in accordance with the Technical Manual on Brand Protection"[375]. It is possible to draw two

[370] *Ibid.* at article 41(d).

[371] *Ibid.* at article 40(d).

[372] *Ibid.* at article 48(c).

[373] International Olympic Committee (IOC), "Glossary, Section III" in *Technical Manual on Brand Protection*, (Lausanne, SZ: International Olympic Committee), online at: <www.olympic.org> (Last accessed: December 1, 2010) at 9 [IOC, *Technical Manual*].

[374] *Ibid.*

[375] IOC, *Host City Contract*, *supra* note 366 at article 48(c).

conclusions from the above provisions. First, the Host City, the NOC and the OCOG inherent great responsibilities regarding the protection of ambush marketing. Second, these stakeholders are also responsible for lobbying activities, namely ensuring that the national government adopts the necessary special legislation to adequately protect the Olympic symbols.

3. The Technical Manual on Brand Protection

By virtue of Rule 51 (1) of the Olympic Charter, the IOC Executive Board is responsible for determining "the principles and conditions under which any form of advertising or other publicity may be authorised"[376]. All participants are expected to comply with "the manuals, guides, or guidelines" issued by the IOC Executive Board[377]. As referenced in Article 48 (c) of the Host City Contract (HCC), the Technical Manual on Brand Protection (the Brand Protection Manual) is an integral part of said contract[378].

The main purpose of the Brand Protection Manual is to assist the Olympic Candidate Cities and the OCOGs in the preparation for the Olympic Games. In particular, it seeks to illustrate what OCOGs must do to protect the intellectual property rights of Olympic marketing partners[379]. The Brand Protection Manual explains that ambush marketing protection is important because "unauthorised associations diminish the value of Olympic partnership investments and tarnish the image of the Olympic Movement"[380]. Michael Payne, the IOC Marketing Director, contends that "if ambush marketing tactics succeed, partners might cease to support the Olympic Movement"[381], and consequently, "if partners cease to support the

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[376] *Charter*, *supra* note 327 at Rule 51(1).

[377] *Ibid.* at Rule 51(9).

[378] IOC, *Host City Contract*, *supra* note 366 at article 48(c).

[379] IOC, *Technical Manual*, *supra* note 373 at section 1 ("The Objective of the Manual").

[380] *Ibid.*

[381] *Ibid.*

Olympic Movement, the future of sport will be jeopardised"[382]. Clearly, the IOC is aware that a loss of corporate confidence in the Olympic sponsorship programme has the potential to erode the overall revenue base of the Olympic Movement.

The Brand Protection Manual provides a list of concrete measures that OCOGs must take in relation to ambush marketing practices. The list contains a number of prevention, protection, and even confrontation measures. For instance, the OCOG legal department is expected to maintain (1) a register of Olympic marketing partners and (2) a brand protection database of all ambush marketing activities, "with documentation of the OCOG action taken to stop the ambush campaign"[383]. The Brand Protection Manual gives indications on how database entries should be organized[384]. It also provides templates of incident report forms[385] and a daily assignment list destined to brand protection officers[386].

The Brand Protection Manual goes as far as outlining the responsibilities, skills, and required experience of all staff working in the brand protection department[387]. A template of a cease-and-desist letter from the OCOG to an ambush marketer is also provided[388]. Appendix II of the Technical Manual provides a list of Olympic-Related Legislation.

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[382] *Ibid.*

[383] *Ibid.* at 61.

[384] *Ibid.* at 62.

[385] *Ibid.* at 130.

[386] *Ibid.* at 128.

[387] *Ibid.* at 122.

[388] *Ibid.* at 117.

IV. Conclusion

This chapter demonstrated how the governance structure of the Olympic Movement coupled with the strategic alliance formed by the IOC and corporate sponsors has proved beneficial to all parties involved in the sponsorship transaction. In doing so, it suggested that strategic alliances based on resource complementarity can become effective vehicles for legally astute teams strategizing to maintain their firm's competitive advantage. In this case, the institutionalization of the sponsorship structure, which in turn delegated legal enforcement and lobbying responsibilities to interested parties – host cities and governments – minimized legal risks and eliminated almost all transaction costs typically incurred by investors in sponsorship structures. Lawyers were certainly instrumental in designing this bullet-proofed governance structure that allows the injection of massive and continuous funds into the Olympic Movement. To employ Barney's terminology, the governance structure of the OIC is in itself valuable and unique, but it only becomes inimitable and nonsubstitutable when paired up with powerful – and wealthy – strategic partners.

The Role of Legal and Political Astuteness in Start-Up Ventures: The Case of Porter Airlines

> "Nobody likes competition. Air Canada hates competition. Westjet hates competition. And most importantly, the new entrants don't know how to be competitive because they end up being kamikazes."
>
> Ted Shetzen, Executive Vice-President, Roots Air[389]

The previous chapter demonstrated that global firms seeking to achieve sustained competitive advantage in the sports sponsorship industry could do so through strategic alliances based on legal resource complementarities. In the case above, the legal framework offered by the Olympic Movement was clearly instrumental to the success of the Olympic sponsorship program. Not only did it minimized the transaction costs associated with most multijurisdictional contracts, but it also eliminated the legal risks involved with sponsorship deals in regards to the protection and enforcement of trademark rights, and more particularly ambush marketing practices.

The case study presented in this chapter is about a start-up airline that managed to leverage the legal astuteness and political cleverness of its top management team (TMT) to become the most successful Canadian regional operation of the last decade, Porter Airlines. This study will demonstrate that changes to the regulatory landscape can open up business

[389] Cited in Keith McArthur, *Air Monopoly: How Robert Milton's Air Canada Won – and Lost – Control of Canada's Skies* (Toronto, ON: McClelland & Stewart Ltd, 2004) at 92.

opportunities for airline entrepreneurs. In particular, it contends that senior executives willing to leverage their understanding of the local regulatory environment can achieve sustained competitive advantage in contested regional markets. In the case of Porter Airlines, the willingness of its founder, Robert Deluce, to consider a number of nonmarket elements in his initial business plan proved to be a great attitudinal asset. Down the road, the legal astuteness and political cleverness demonstrated by Porter's TMT permitted the signature of an important commercial agreement that guarantees, to this day, Porter's dominant position in Toronto's downtown airport. In sum, the study essentially suggests that the unique, rare, inimitable, and nonsubstitutable relationship developed by a start-up airline with a strategic stakeholder in its immediate nonmarket environment can be a source of sustained competitive advantage. Arguably this has been the case for Porter Airlines despite the aggressive litigation tactics launched by Air Canada since 2006.

Part I will provide a brief overview of the competitive and regulatory environment that affect the airline industry in general, and start-ups in particular. Special attention will be paid to Air Canada's history of anti-competitive practices in the industry. It will also evaluate the commercial rationale behind the establishment of Porter Airlines. **Part II** will address the politics of new airline entry in the Toronto market and how these came to affect the feasibility of Porter's initial business plan. **Part III** will demonstrate that Porter Airlines benefited greatly from the legal activism and newly acquired powers of the Toronto Port Authority (TPA) in the early 2000s. In particular, senior managers and their lawyers were astute enough to capitalize on both entities' desire to resuscitate the once moribund Toronto's City Centre Airport (TCCA). The legal settlement and commercial agreement signed by both parties bullet-proofed Porter's

operations and ensured the emergence of a successful city-centre airport in Canada's financial capital.

I. The Regulatory and Competitive Landscape of the Airline Industry

A. The Airline Industry is Heavily Regulated by Public Authorities

In contrast with the global sponsorship industry, commercial aviation emerges as one of the five most regulated sectors of the economy, especially in the realm of competition, safety, security, and consumer protection[390]. Moreover, airlines are usually subject to local legislation in the areas of tax and bankruptcy, as well as employment and labour laws[391]. Publicly-traded carriers are additionally regulated by comprehensive and rather complex networks of securities and financial laws and regulations[392]. Given the international nature of aviation, airlines are also subject to a body of multilateral conventions that govern safety, liability, navigation services, as well as other aspects of civil aviation[393]. Finally, airlines must comply with a body of technical requirements imposed by competent governmental authorities. These may include air operator certificates, air worthiness certificates, aircraft registrations, cabin safety and transportation of dangerous goods standards[394]. For international airlines, the bilateral agreements signed – or yet to sign – by their respective countries of registry can

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[390] In Canada, see especially, *Competition Act*, R.S., 1985, c. C-34; *Aeronautics Act*, R.S., 1985, c. A-2; *Canada Transportation Act*, 1996, c. 10; *Consumer Reporting Act*, R.S.O. 1990, c. C.33 (Ontario), *Consumer Protection Act*, R.S.Q. c. P-40.1 (Quebec).

[391] Canadian airlines are subject to the following pieces of legislation: *Income Tax Act*, R.S.C. 1985 (5th Supp.), c. 1; *Bankruptcy and Insolvency Act*, R.S.C. 1985, c. B-3; *Canada Labour Code*, R.S., 1985, c. L-2.; *Public Service Labour Relations Act*, S.C. 2003, c. 22.

[392] See especially, *Securities Act*, R.S.O. 1990, c. S.5 (Ontario); *Securities Act*, R.S.Q. c. V-1.1 (Quebec).

[393] See especially, *Chicago Convention on International Civil Aviation*, 7 December 1944, 15 U.N.T.S. 295 (Entered into force 4 April 1947); *Montreal Convention for the Unification of Certain Rules for International Carriage by Air*, 28 May 1999, 2242 U.N.T.S. 350 (Entered in force 4 November 2003).

[394] See Transport Canada, *Starting a Commercial Air Service* (November 2004), TP 8880E.

influence aspects such as route structure, code-sharing arrangements, and ultimately market development.

B. Airports Are Key Determinants of Success for Start-Up Airlines

Airlines are often dependent on governmental policies regarding airport infrastructure and air navigation services. Government intervention can either enhance or negatively affect the development of airports. The misguided expansion and abrupt death of the Montreal-Mirabel International Airport illustrates the extent to which governments can negatively influence local airport development and, par ricochet, the airline industry[395].

Factors such as the **geographical location**, **landing fees**, **available landing slots** and **governance structure** of airports can often determine whether a new business model is likely to become successful. For example, **Low-Cost Carriers (LCCs)** – or Discount/No-Frills Airlines – are well known for operating out of secondary airports. Landing fees at these airports are less expensive compared to those charged by international airports where major airlines have historically established their hubs. Since the operational structure of LCCs is based on a point-to-point route system, and their target customers are highly price sensitive, airport location and capacity may not be key determinants of commercial success. In contrast, the relative success of **Network Carriers (NCs)** – or International Airlines – has been primarily determined by their sophisticated route system based on a hub-and-spoke model. This model has permitted NCs to offer "long-haul, connecting traffic, in both dense and thin markets, many of whose passengers have complicated itineraries". In the post-deregulation era, NCs have become

[395] See Elliot J. Feldman & Jerome Milch, *Technocracy versus Democracy: The Comparative Politics of International Airports* (Boston, MA: Auburn House, 1982).

talented at creating international strategic alliances especially manufactured to siphon local traffic into their international network.

Porter Airlines can be described as a premium regional airline targeting primarily time sensitive business people. Accordingly, the level of customer service offered is above-average industry standards[396]. The route structure is based on a point-to-point model and the range of cities deserved is limited by the type of aircraft permitted to land in Toronto's downtown airport – officially referred to as Toronto's City Centre Airport (TCCA). The TCCA presents a number of advantages for Porter Airlines. First of all, its proximity to Toronto's financial district and the small size of the airport offers the advantage to reduce travelling times for passengers. Porter's top management team (TMT) estimated that for travellers originating from or destined to downtown Toronto, using the TCCA "would save approximately 1.33 hours compared to using Pearson airport"[397], Air Canada's main hub and Westjet's base. Landing fees and other ancillary airport operation costs are certainly the second advantage of the TCCA, also classified as a secondary airport. According to the same estimate referred to above, "the fees charged to airlines operating from the TCCA [are] approximately 50% of those charged at Pearson"[398].

As will be discussed in **Section III** of this chapter, the Toronto Port Authority (TPA), the federal agency responsible for the development of the TCCA has also benefited from Porter's commitment to base its operations on and invest in Toronto's downtown airport. According to a competitive analysis based on Barney's theory of resources, it becomes clear that the marriage between Porter Airlines and the TCCA is likely to generate a natural comparative advantage.

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[396] Sandra Arnoult, "Big Fish Small Pond", *ATW Magazine* (October 2008) at 68 ("Its business […] is built on superior inflight service, fast passenger processing and convenient access to the country's business capital.")

[397] Michael Deluce & Guy L.F. Holburn, "Porter Airlines: A Political Fight for Flight" (case study) (London, ON: Richard Ivey School of Business Foundation, 2009) at 2 [Deluce, "Porter Case Study"].

[398] *Ibid.*

This thesis contends that the commercial agreement that currently exists between Porter Airlines and the TPA is a source of sustained competitive advantage. More importantly, the existence of such agreement is a direct consequence of Porter's legally-astute TMT.

C. New Airline Entrants Often Face Predatory Practices

According to Dempsey, start-up airlines can fail for a number of external reasons. For example, rising fuel costs, a sudden economic recession, and terrorist attacks can all destroy a new venture. However, start-up airlines face major (anti-)competitive challenges from within the industry. The most important hurdle to commercial success, however, comes from established Network Carriers (NCs). Predatory practices are, in fact, common currency in contested lucrative markets and evidence show that they often drive new entrants into bankruptcy[399]. Porter's TMT certainly took this factor into consideration when assessing the market environment of the new airline, particularly in light of Air Canada's dominance in the Toronto market.

Dempsey describes the homicidal cycle in as follows: "(1) [a] major airline establishes monopoly in a market, and raises prices to confiscatory levels, (2) [a] new low-cost airline enters the market, offering low fares, (3) [the] major airline responds by matching fares (even if below cost), sometimes adding aircraft capacity and frequency (…), (4) after suffering severe economic losses, [the] new entrant airline withdraws from the market, (5) [the] major airline

[399] See particularly, Dempsey, "Predatory Pricing", *supra* note 11. For a Canadian perspective, see Eckert & West, "Predation", *supra* note 11. For a critical analysis on how network airlines react to the entry of low-fare airlines in a particular market, see Robenault, "Predatory Pricing", *supra* note 11. For an analysis on the strategic foundations of predatory pricing, see Elzinga, "Predatory Pricing", *supra* note 11.

reduces service and raises prices to confiscatory levels, often higher than those prevailing before the new entrant emerged"[400].

It is important to note that Air Canada has historically played the "anti-competitive practices" card to new entrants in various markets[401]. Unfortunately, the only recorded case of predatory practices that receive judicial attention was Air Canada's anti-competitive behaviour in seven Central and Atlantic Canada routes[402]. The new airline entrants affected in this case were Westjet, a Calgary-based LLC, and Canjet, a Halifax-based LLC that subsequently declared bankruptcy. In its 2003 decision, the Competition Tribunal of Canada found that: "in the period from April 1, 2000 to March 5, 2001, Air Canada operated or increased capacity at fares that did not cover the avoidable costs of providing the service"[403] on the Toronto-Moncton/Moncton-Toronto and Montreal-Halifax/Halifax-Montreal routes. Porter Airlines was certainly aware of Air Canada's relative dominant position in the Toronto market and sought to avoid entering into futile price wars. In order to achieve this objective, obtaining a preferential access to Toronto's secondary airport – the TCCA – was to become a business priority for the company. Perhaps even a prerequisite for long-term survival. As will be discussed in **Part II** and **Part III** of this chapter, a comprehensive assessment of its nonmarket

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[400] Dempsey, *Airline Management Strategies*, *supra* note 108.

[401] "Air Canada Faces Charges of Anti-Competitive Behavior", *World Airline News* (March 9, 2001), online at <http://findarticles.com/p/articles/mi_m0ZCK/is_10_11/ai_71570593/>; "WestJet Airlines: Toughen Competition Act to Prevent Anti-Competitive Practices, WestJet...", *Business Wire* (November 7, 2001), online at <http://www.allbusiness.com/transportation/air-transportation-aviation/6142917-1.html>; "Porter Sues Air Canada for $850M", *Financial Post* (October 26, 2007), online at <http://www.canada.com/windsorstar/story.html?id=bc511658-5758-45cf-9d99-70ed4aa6b681&k=5503>.

[402] Routes: St. John's-Halifax; Montreal-Halifax; Ottawa-Halifax; Toronto-Moncton; Toronto-Fredericton; Toronto-Saint John; and Toronto-Charlottetown. Cited in *Commissioner of Competition v. Air Canada,* 2003 Comp. Trib. 13 at para. 2.

[403] *Ibid.*

environment coupled with the TMT's legally-astute attitude became Porter's two most important managerial assets/resources.

II. The Politics of New Airline Entry in Toronto's Downtown Market

The development of Toronto's City Centre Airport[404] (TCCA), and particularly the construction of a bridge to the island, has been in the forefront of city politics for almost a century. It has either been vehemently opposed or passionately supported. Just like in Shakespeare's Romeo and Juliet, the tension created by extreme feelings of love and hate has generated a powerful dialectic that has shaped many of Toronto's economic development policies. Like in most heavily regulated industries, various political bodies had jurisdiction over fundamental aspects of airport development and the regional industry business. Porter Airlines was no exception.

A. General Overview

In the case of Porter, the Toronto City Centre Airport (TCCA) is operated by the Toronto Port Authority (TPA) on land owned by the federal government. TCCA operations are governed by a Tripartite Agreement adopted in 1983 by the Toronto Harbour Commission (TPA's predecessor), the Minister of Transport (federal-level) and the City of Toronto (municipal-level). In sum, the Tripartite Agreement provides the terms and conditions governing the TCCA. For example, it determines the types of aviation services allowed on the island, the use and construction of runways, and most importantly, the construction of any bridge or ferry to the

[404] Commonly known as the "Toronto Island Airport", and officially known as the "Toronto City Centre Airport," the Toronto Port Authority (TPA) renamed it "Billy Bishop Toronto City Airport" on November 10, 2009. IATA Airport Code: YTZ.

mainland. As will be discussed below, all three parties must approve any amendment to the Agreement necessary to refurbish infrastructure facilities. Porter's TMT had expressed its preference for a short bridge – the famously litigated "fixed-link" – that would link the shore to the island (the fixed-link). As explained by Michael Deluce, "If Deluce was to proceed with his plans for expansion, obtaining the formal approval of the parties to amend the tripartite agreement would be critical"[405].

B. The Tripartite Agreement: An Overview

In 1983, the City of Toronto, the Toronto Harbour Commission (THC) and Transport Canada decided to establish a fifty-year Tripartite Agreement – also referred to as the 1983 Agreement[406] – that provided a regulatory framework for the use of the TCCA. It contained, for example, several restrictions on the type of aircraft allowed to land at the airport[407], a provision prohibiting the addition of new runways or the extension of current runways[408], a clause prohibiting the landing of jet powered aircraft, except for medical evacuation flights (MEDEVAC)[409]. It also contained several restrictions on noise levels[410].

Further, by virtue of Article 14 (1) (b), the Tripartite Agreement prohibited the construction of a fixed link, bridge or tunnel to the Island: "[t]he Lessee shall not construct or permit to be constructed a bridge or vehicular tunnel providing access between the mainland

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[405] Deluce, "Porter Case Study", *supra* note 397.

[406] Canada, Department of Transport, *Agreement to Provide for the Continued Use of Certain Parcels of Land at Toronto Island for the Purpose of a Permanent Public Airport for General Aviation and Limited Commercial STOL (Short Take-Off and Landing) Service Operations*, File No. 1380-22, No. 117247. Original version found at the Toronto Public Library (Unique Collections), Urban Affairs Library, on March 24, 2010.

[407] *Ibid.* at article 9.

[408] *Ibid.* at article 14(1)(a).

[409] *Ibid.* at article 14(1)(d).

[410] *Ibid.* at article 14(1)(e) and (f)(i)(ii).

and the Island Airport"[411]. It also regulated the use of certain parcels of land on the island, particularly on the maintenance of buildings and improvements[412], liens[413], drainage and discharge of material[414], quiet enjoyment[415], easements[416], and the right to construct and access[417]. At Porter's advantage, the Tripartite Agreement failed to provide a threshold for the maximum number of flights per day or number of passengers allowed per year. It established, however, clear noise exposure parameters[418]. As explained by Deluce, these environmental restrictions meant that jet aircraft were banned and that Porter was left with very little choice in terms of type of aircraft for its fleet[419]. According to the Tassé Report, the 1983 Agreement was politically designed to balance the interests of various stakeholders in the development of Toronto's waterfront, including the TCCA[420].

Arguably Porter's TMT proficiency with local politics and its founder's understanding of the nonmarket environment are two key elements that allowed the Porter–TPA informal alliance to materialize, and subsequently to become a source of sustained competitive advantage. Moreover, the Tripartite Agreement is an illustration of how governmental authorities can use legal instruments at their disposal to affect a firm's competitive landscape. Porter's ability to scan its legal sphere is noteworthy. **Section III** will demonstrate how Porter's

[411] *Ibid.* at article 14(1)(b).
[412] *Ibid.* at article 18.
[413] *Ibid.* at article 19.
[414] *Ibid.* at article 20.
[415] *Ibid.* at article 21.
[416] *Ibid.* at article 23.
[417] *Ibid.* at article 42.
[418] *Ibid.* at article 14 (f)(i)(ii) and articles 27 and 34.
[419] Deluce, "Porter Case Study", *supra* note 397 at 2.
[420] Roger Tassé, *Review of Toronto Port Authority Report* (Ottawa: Transport Canada, 2006) at 13 [Tassé, *Review*].

TMT, including their external lawyers, were instrumental in the resuscitation of the TCCA and the new airline's operational and financial viability.

III. The Rise of the Toronto Port Authority

At the peak of the 90s economic recession, all levels of government in Canada were running chronic budgetary deficits. This situation forced governments to implement a number of unprecedented austerity measures in order to stop the bleeding. The following section will briefly review the legislative events that led to the creation of the Toronto Port Authority (TPA) in 1999. As will be discussed, the final objective of the Canada Marine Act was to divest the federal government from port operations with the objective of making them financially self-sufficient.

This section will primarily analyze the legal initiatives undertaken by the TPA in light of Porter's own commercial objectives, including all related litigation and settlement agreements. Bottom line, it will demonstrate that previous legal and political astuteness in heavily regulated industries can facilitate the creation of informal alliances or contractual arrangements with like-minded stakeholders. These strategic alliances can soon become sources of sustained competitive advantage because other competitors simply do not possess the ability to imitate or substitute them with similar arrangements and/or legal instruments.

A. The Birth of the Toronto Port Authority

The Canada Marine Act (CMA)[421] seeks to make the national system of ports more competitive, efficient, and commercially oriented. It also contains a number of sections to ensure that transparency, accountability and responsibility are the core values guiding the

[421] *Canada Marine Act*, S.C. 1998, c. 10.

work of newly-formed Port Authorities. What follows is an overview of the most relevant provisions of the CMA as it relates to the governance structure and powers of the Toronto Port Authority (TPA), particularly vis-à-vis the City-Centre Airport.

1. Governance Structure of the Toronto Port Authority

Under the Letters Patent authorizing the creation of the Toronto Port Authority (TPA), the Board of Directors is made of seven members[422], one appointed by the Government of Canada, one by the City of Toronto, one by the Province of Ontario and four by the federal government in consultation with the Minister[423]. Directors are appointed to hold office for any term of not more than three years and terms can only be renewed twice[424]. Furthermore, directors must possess relevant knowledge and extensive experience related to the management of a business, and especially in the operation of a port[425].

The annual meeting of the TPA must be open to the public and held in Toronto, in premises large enough to accommodate the anticipated attendance[426]. The TPA must make available for inspection of the public its audited financial statements and those of its wholly-owned subsidiaries for the preceding fiscal year[427]. The annual financial statements must set the total remuneration paid in money or in kind, including any fee, allowance or other benefit granted to the directors, the chief executive officer, and all the officers and employees whose remuneration exceeds a prescribed threshold[428]. Furthermore, a special examination of the

[422] *Ibid.* at s. 4.3.
[423] *Ibid.* at s. 4.6.
[424] *Ibid.* at s. 14(2).
[425] *Ibid.* at s. 15 (1)(2).
[426] *Ibid.* at s. 35(1).
[427] *Ibid.* at s. 37(1).
[428] *Ibid.* at s. 37(3).

TPA's books, records, systems and practices must be carried at least once every five years and at any additional times that the Minister of Transport may require[429].

2. Powers of the Toronto Port Authority

The TPA is an agent of Her Majesty in right of Canada only for the purposes of operating port activities related to shipping, navigation, transportation of passengers and goods, handling of goods and storage of goods, to the extent that those activities are specified in the letters patent[430]. Most importantly, the Toronto Port Authority (TPA) has the power to run other businesses (i.e., a secondary airport) at its own expense, but subject to its Letters Patent, to any other legislation, and to any other Agreement (i.e., the Tripartite Agreement of 1983) with the Government of Canada[431]. Regarding the operation of TCCA, the TPA has the power to enforce regulations made by the Minister for the purpose of providing unobstructed airspace for the landing and taking off of aircraft at the airport[432]. These regulations must be exclusively for the regulation and control of the airport and all the persons engaged in the operation of aircraft at the airport. They may prohibit the landing or taking off of aircraft of a certain type or aircraft exhibiting certain characteristics[433].

The Letters Patent also outline a list of activities that the TPA is empowered to carry out[434], as well as all the conditions and limitations under which these activities must be undertaken. For example, the Letters Patent expressly indicate that the TPA may undertake the operation and maintenance of the TCCA in accordance with the Tripartite Agreement. Operation and

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[429] *Ibid.* at s. 41(1)(2).

[430] *Ibid.* at ss. 7(1) and 28(2)(a).

[431] *Ibid.* at s. 29(1)(3).

[432] *Ibid.* at s. 63(1).

[433] *Ibid.* at s. 63(3).

[434] Canada Gazette, Part 1, vol. 133, no. 23 (June 5, 1999).

maintenance activities include the creation of a ferry service, bridge or tunnel across the Western Gap of the Toronto Harbour in order to provide access to the Toronto City Centre Airport[435]. Interestingly, the Letters Patent allow the TPA to administer, lease or license real property, other than federal real property, such as restaurants, retail operations, tourist services and similar tourism-related activities, located in passenger terminal facilities provided such uses are related to the transportation of passengers through the port and are compatible with the land-use plan of the port[436]. These powers arguably allow the TPA to run commercial operations on the TCCA, inside or outside the designated passenger terminal.

B. The Toronto Port Authority Takes the Lead

In the years that followed the adoption of the Canada Marine Act, the TPA became very active in developing a long-term viable business plan for the Toronto Harbourfront. Concurrently, it sought to defend its institutional autonomy by holding the federal and municipal governments accountable for their actions through judicial means. The legally astute approach of doing business displayed by the TMT until now would eventually find a way to capitalize from the TPA's newly found legal assertiveness. The Commercial Carrier Operating Agreement (CCOA) would subsequently become the single most important legal tool to ensure Porter's commercial viability in the Toronto market. It would also become a key developmental tool for the TPA and the TCCA.

[435] *Ibid.* at art. 7.2(j).

[436] *Ibid.* at art. 7.2 (f)(iii)(A).

1. The Commercial Potential of the Toronto City Centre Airport

In the weeks that followed its creation, the TPA decided to commission a series of reports in order to assess the commercial viability of the Toronto Harbourfront in general, and the TCCA in particular[437]. The first report, the Mariport Report, provided the TPA with a list of future development opportunities and potential lines of business for the TCCA[438]. It noted, for example, that the transportation of passengers and freight could be a viable commercial opportunity[439]. Regarding the short bridge – the famous "fixed link" – the Report noted that, despite having received the municipal government's approval in 1998, the TPA did not possess the fundraising capacity to fully finance the project[440].

The second evaluation report[441] commissioned by the TPA, the Sypher Report, concluded that ensuring direct access to the airport from the downtown core would determine the TCCA's long-term commercial success[442]. Interestingly, it noted that the TCCA's natural niche market is and is likely to remain the financial district community[443]. In particular, the study recommended that ownership of landing slots at the TCCA should remain property of the TPA in the future, and that these should only be licensed to air carriers for specific periods of time[444]. The Sypher Report also found a shortage of Air Ontario – then Air Canada's regional

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[437] The Mariport Group Ltd, "Evaluating the Port of Toronto: Markets and Impacts on the GTA", *Submitted to the Toronto Port Auhority* (Cambridge, ON: The Mariport Group Ltd., December 1999), online: < http://www.mariport.com/pdf/Evaluating%20the%20Port%20of%20Toronto.pdf> (Last accessed: April 21, 2010).

[438] *Ibid.*

[439] *Ibid.* at 4-32.

[440] *Ibid.* at 3-5.

[441] Sypher: Muller International, "Toronto City Centre Airport General Aviation and Airport Feasibility Study: Small Footprint, Big Impact", in *Report Prepared for the Toronto Port Authority* (2001).

[442] *Ibid.* at 85.

[443] *Ibid.*

[444] *Ibid.* at 88.

carrier – marketing for services from and out of the TCCA. It went as far as to suggest that travel agents be offered $10 gifts to boost passenger traffic levels[445]. Finally, it pointed to the fact that business travelers would be willing to pay a price premium for each hour of travel time reduced in their itinerary[446].

The Sypher Report also drew the TPA's attention to the main competitive advantages of downtown regional airports, namely lower operating costs for managers, avoidance of transportation hassles for travellers, and easy access to the downtown's cultural and sporting activities for tourists[447]. The report acknowledged, however, that the future of the TCCA is intrinsically – and inevitably – linked to the urban development objectives of the City of Toronto, thus inferring that municipal politics would continue to play a role in the development of the TCCA. In any case, the report made clear that the status quo could no longer be a viable option. It was impossible to confirm whether Porter's TMT ever read the Sypher Report before crafting its initial business plan. Based on the analysis and recommendations offered though, it is possible to deduct that Porter's TMT used the Sypher Report as a preliminary market analysis.

2. The Toronto Port Authority Attempts to Establish Bridges with the City of Toronto

In January 2002, the TPA transmitted a copy of the Sypher Report to Mel Lastman, then Mayor of Toronto, and David Collenette, then federal Minister of Transportation[448]. The underlying idea was to promote informed public discussions on the future of the TCCA. Four

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[445] *Ibid.* at 89.

[446] *Ibid.* at 90.

[447] *Ibid.* at 91.

[448] Tassé, *Review*, *supra* note 420 at 32.

months later, the Board of Directors of the TPA informed the Minister of Transport that it had developed a clear position regarding the future of the TCCA[449]. The proposed statement of vision provided that "a viable TCCA is an important asset for the City of Toronto and provides a significant opportunity for Toronto to distinguish itself as a world class city"[450]. The TPA would finally announce its business plan for the TCCA in the fall of 2002. The plan included the following elements: (1) a comprehensive financial assessment and business plan, (2) an agreement with a regional carrier, (3) a design concept for a "fixed-link" to the mainland, and (4) the construction of a new terminal[451].

After thorough review by the Waterfront Reference Group, it was recommended that City Council support the expansion of the TCCA but only under certain conditions, "one of those conditions being the resolution of the lawsuit between the City of Toronto and the TPA"[452]. The Toronto Port Authority (TPA) was of the view that some land transfers between 1991 and 1994 were engineered by and for the benefit of the municipal government, disregarding at the same time the interests of the TPA's predecessor, the Toronto Harbour Commission (THC). The TPA essentially claimed that the city-appointed commissioners had breached their fiduciary duties to the THC[453].

[449] *Ibid.*

[450] *Ibid.*

[451] *Ibid.* at 34.

[452] *Ibid.* at 35.

[453] *Ibid.* at 36.

3. The Toronto Port Authority Embraces Legal Activism

a) Settlement on the Land Transfers

The lawsuit launched by the TPA against the City of Toronto on the land transfers was a clear attempt to assert its autonomy. Although the negotiations that preceded the Settlement Agreement were "prolonged, intensive and complex"[454], the process itself was an opportunity for both parties to make compromises and re-establish an equilibrium that was lost during the THC era. The final Settlement Agreement speaks for itself. The City of Toronto was allowed to keep the 600 acres of land in dispute. This would allow municipal authorities to commence a plan of waterfront revitalization[455]. The City also obtained a promise from the TPA that the aircraft to be purchased by Porter Airlines would be manufactured in the Greater Toronto Area (GTA)[456]. It must be noted that the TPA and Porter Airlines had already entered into an agreement that allowed commercial operations to and out of the TCCA.

The gains for the TPA were substantial. Perhaps the most important gain was the approval by the federal and municipal government to amend the Tripartite Agreement of 1983. These amendments would facilitate the launch of Porter Airlines because the TPA was given the authorization to proceed with the construction of the "fixed-link" and a new terminal at the TCCA[457]. Unfortunately for the TPA and RegCo – corporate predecessor of Porter Airlines – the provincial Tories faced a serious setback during the municipal election of November 2003. Social-democrat David Miller was elected Mayor and he soon voiced his opposition to the

[454] *Ibid.* at 37.
[455] *Ibid.* at 38.
[456] *Ibid.* at 39.
[457] *Ibid.* at 40.

construction of a "fixed-link" between the mainland and the TCCA[458]. According to him, uncontrolled airport development in the middle of the City would harm the redevelopment and revitalization of the waterfront[459].

At its first meeting of December 3, 2003, the newly elected City Council withdrew its support for the construction of the "fixed-link" and asked the federal government to re-amend the Tripartite Agreement of 1983[460]. The main purpose was to remove the newly amended provision that allowed for the construction of the "fixed-link". Not surprisingly, this political move would resume the municipal government' hostilities with the TPA. Three issues were potentially subject to litigation: (1) the costs already incurred by the TPA regarding the construction of the bridge, (2) the possible third party claims (i.e., RegCo) that would arise from the cancellation of the bridge, and (3) the ensuing liability of the TPA[461]. According to some estimates, a breach of contract would cost the TPA approximately $35 million[462]. After considering the potential legal risks and liabilities of re-amending the Tripartite Agreement, the federal government decided to stop the "construction of the fixed-link by using a regulatory instrument as opposed to a contractual one and it authorized pre-publication of the proposed regulation in the *Canada Gazette*"[463]. In September 2004, Transport Canada agreed

[458] Gene Desfor *et al.*, "From Surf to Turf: No Limits to Growth in Toronto?" (2006) 77 Studies in Political Economy 131 at 152.

[459] *Ibid.*

[460] Tassé, *Review*, *supra* note 420 at 41.

[461] *Ibid.*

[462] Bersenas, Jacobsen, Chouest, Thomson, Blackburn LLP, "Turbulence at Toronto City Centre" (March 3, 2007) 3.3 *Transportation Notes* 3 at 3 [Bersenas, "Turbulence"].

[463] Tassé, *Review*, *supra* note 420 at 47. See also, *Regulatory Impact Analysis Statement* (RIAS), Canada Gazette, Part I (21 June 2004).

to meet with the TPA in order to negotiate a final settlement that would cover the various claims – Aecon, Stolport, and RegCo.[464] – arising from the cancellation of the bridge.

b) Settlement on the Fixed Link

The arduous negotiation process that led to this multi-party Settlement Agreement confirms, in a way, the prominent role occupied by the TCCA in Toronto's economic development agenda. What follows is an overview of the Settlement Agreement.

First of all, the federal government (Transport Canada), the TPA and the City of Toronto obtained the release of all potential claims that Aecon, Stolport and RegCo. might have had due to the cancellation of the bridge. Second, the Settlement Agreement included a payment of $35 million to the TPA, by Transport Canada, for all its sunk costs, legal costs and losses of net revenues resulting from the re-amendment of the Tripartite Agreement[465]. Most importantly, the TPA decided to enter into a confidential Commercial Carrier Operating Agreement (CCOA) with RegCo. in order "to help mitigate their respective claims"[466]. But the TPA also obtained an important concession from RegCo. As per the Settlement Agreement, RegCo is required to make substantial investments in the TCCA infrastructure[467] and to guarantee a minimum level of

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[464] ***Aecon*** had been hired to construct of the bridge and had already started some design and drafting work. ***Stolport*** was the owner of a Hangar that had been demolished during the design process of the proposed fixed link. ***RegCo*** was the future operator of a regional airline based out of the TCCA. It had spent significant sums of money in launching the airline. Not to mention that one of the prerequisites of their business plan was the construction of a fixed link to the mainland.

[465] Tassé, *Review*, *supra* note 420 at 50.

[466] *Ibid.*

[467] *Ibid.* at 55.

usage[468]. In return, the TPA committed to improve the access to the TCCA through the purchase of a new ferry[469].

In Bersenas's view, "the negotiations eventually turned to the possibility of a business arrangement between the TPA and Deluce which would allow the airline venture to proceed, thereby reducing Deluce's damages and providing a potential source of income for the TPA". To this day, the details of the CCOA between the TPA and RegCo remain confidential. The CCOA, however, has been highly questioned by Air Canada and Jazz in all court levels and by all judicial means[470]. They maintain, in particular, that the CCOA is, by its very nature, an anti-competitive and unfair agreement that was astutely crafted to exclude Jazz from operating from the TCCA. It must be noted, however, that a few months before the launch of Porter Airlines, the TPA advised Jazz that their old lease agreement was to expire in August 2006 and consequently the regional airline would not be able to operate out of the TCCA beyond the last day of August. The TPA proposed a new CCOA but Jazz refused on the grounds that "the terms were arbitrary and harsh, in particular that they imposed unfair restrictions on its access to slots, destinations, and routes"[471]. Jazz would subsequently launched litigation both in the Superior Court of Ontario and in the Federal Court of Canada[472]. The CCOA between Porter Airlines and the TPA has not been invalidated by the courts until this day.

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[468] Bersenas, "Turbulence", *supra* note 462.

[469] Tassé, *Review*, *supra* note 420 at 56.

[470] *Jazz Air LP v. Toronto Port Authority*, 2007 FC 114; *Air Canada v. Toronto Port Authority*, 2010 FC 774; *Jazz Air LP v. Toronto Port Authority*, 2009 FC 253; *Jazz Air LP v. Toronto Port Authority*, 2007 FC 624.

[471] Bersenas, "Turbulence", *supra* note 462.

[472] *Jazz Air LP v. Toronto Port Authority*, 2007 FC 114; *Jazz Air LP v. Toronto Port Authority*, 2009 FC 253; *Jazz Air LP v. Toronto Port Authority* 2007 FC 624.; *Jazz Air LP v. Toronto Port Authority*, 84 O.R. (3d) 641; *Jazz Air LP v. Toronto Port Authority*, [2006] O.J. No. 1110; *Jazz Air LP v. Toronto Port Authority*, [2006] O.J. No. 3896; *Jazz Air LP v. Toronto Port Authority*, [2007] O.J. No. 809.

IV. Conclusion

It is undeniable that the CCOA with Porter Airlines has allowed the TPA to ensure the long-term viability of the TCCA. For instance, the TCCA seems to have found its niche of travelers, namely business people and other time-sensitive travellers willing to pay more bucks for flexibility. This is very good news for the TPA because it means that even if Porter Airlines goes bankrupt sometime in the future, there will always be another carrier ready to capture that lucrative niche. Second, the emergence of a successful city-centre airport is encouraging for Toronto's long-term economic development. Not only because it creates employment for its local residents, but also because it connects Canada's financial capital with other important cities in the northeast part of the continent. This unique contractual arrangement has allowed the TCCA to acquire a sustained competitive advantage on the short-haul business passenger market. Neither Air Canada nor Toronto's Pearson International Airport possess the ability to imitate or substitute this kind of contractual agreement. In my view, Porter and the TPA have created a source of competitive advantage that is likely to last unless it is invalidated judicially or a new regulatory development comes to change the governance structure of the TPA.

CHAPTER SIX

Conclusion

This thesis has sought to explore whether legal and political astuteness play a role in the attainment and sustainability of a firm's competitive position. Drawing from various academic disciplines, it has attempted to integrate conflicting assumptions and complementary approaches to shed light into this nascent body of literature. From a management perspective, it has considered several questions. For example, (1) which organizational structures are best suited for achieving the benefits of legal astuteness, (2) whether legal considerations tend to be more prevalent in some industries, and (3) how do firms develop, deploy, and optimize resources in order to improve their overall performance and competitive positioning. From a legal standpoint, it has considered questions such as (1) is there any role for lawyers in the formulation and decision-making processes leading to the implementation of corporate strategy, (2) if so, what are the legal instruments, structures, and frameworks that lawyers can proactively exploit to trigger effective and sustainable business strategies.

In the realm of regulated industries (Porter Airlines), it was suggested that legal astuteness implies more than possessing technical skills. It means having a good knowledge and understanding of the regulatory and political landscape on which firms evolve. In the sphere of globalized industries (Olympic Sponsors), it was pointed out that strategic alliances based on resource complementarity can facilitate the development of effective legal risk management systems. This thesis is, in a way, an invitation to reduce the divide that apparently exists

between top management teams and their lawyers. It is also an attempt to bring back legal professionals to the centre of business strategy formulation. Above all, this thesis sought to establish that legal and political astuteness are distinctive and valuable attitudinal assets in globalized and regulated industries, especially at the top management level.

In retrospective, the issue of delegation deserves more attention. As we have seen in Chapter 4, wealthy corporations with plenty of legal resources decided to transfer the legal and political astuteness functions to the IOC and his local partners. As a result, legal risks and transaction costs diminished substantially. Did the IOC create its internal governance structure – and especially the legal instruments discussed in Chapter 4 – with this objective in mind? Can lawyers use similar structures to bullet-proof sponsorship contracts outside the Olympic Movement or the FIFA World Cup? Are membership-based international entities a prerequisite to the development of risk management systems and the optimization of legal resources in the sports sponsorship industry? Is it possible to transfer the IOC-Olympic sponsors-type alliance to other globalized industries?

Chapter 5 demonstrated that start-up ventures in regulated industries can capitalize on the legal structures and mechanisms already in place in order to attain sustained competitive advantage. Porter Airlines, a start-up company with little cash flow, managed to close a deal with the most important stakeholder – the Toronto Port Authority – in its immediate nonmarket environment. As discussed above, the commercial contract can be considered in itself a source of competitiveness. A few questions remain, however. For instance, considering the highly politicized nature of airport policy in Toronto, can legal resources emerge from particular historical conditions? Can start-ups ventures in other regional markets use similar legal mechanisms to keep predatory competitors at bay?

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