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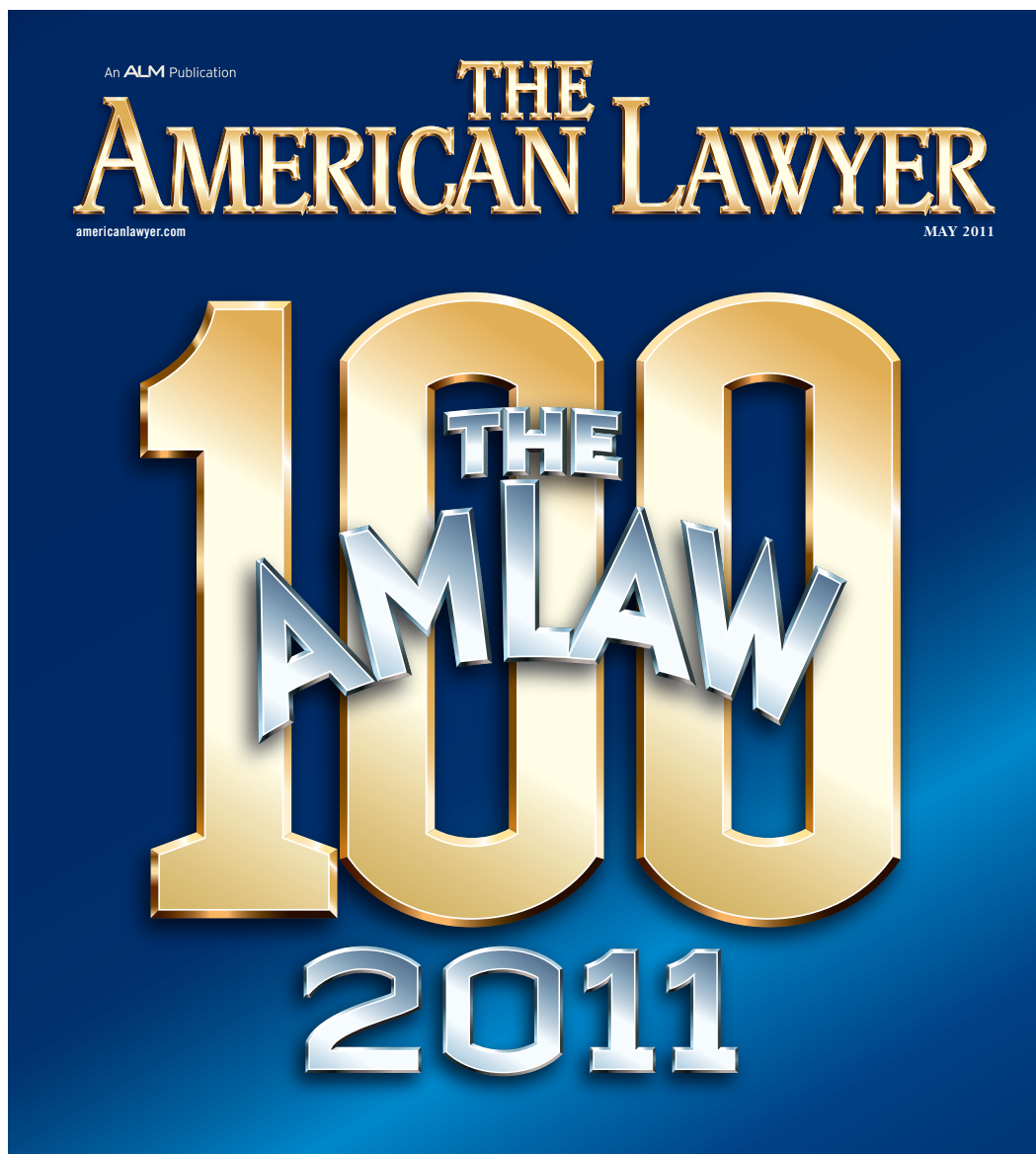
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Grand Illusion

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Featured in



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By Peter Kalis

Grand Illusion

Some of the entrants on this year's Am Law 100 list are firms in name only, contends K&L Gates's chairman.



GIANPAOLO PAGNI

Law firm managing partners await publication of The Am Law 100 with great anticipation. In the publishing industry, rankings are a sure seller, and The Am Law 100 is a ranking par excellence. It's the show-and-tell of the legal industry in the United States. And, while *The American Lawyer* often relies upon law firms

to supply their own financial data, there is widespread belief that the reported metrics are substantially correct.

Until now.

The ranking has been undermined not by law firms but by the magazine itself. Because *The American Lawyer* now treats two or more independent firms within a Swiss *verein* as a single law firm, it has debased the financial results upon which its ranking rests. There is no question that the Am Law 100 ranking works well when it compares single law firms. But if, through the device of a *verein*, two or more law firms are permitted to report results on a consolidated basis, the ranking is distorted, and the value of The Am Law 100 is undermined.

In the obscenity case *Jacobellis v. Ohio*, the late Justice Potter Stewart famously resisted the temptation to define constitutionally unprotected speech and instead relied on the commonsense notion of "I know it when I see it." In a more prosaic setting, the reader here is invited to apply the same test to the simple question, "What is a law firm?" As you might guess, far more turns on the answer than the composition of The Am Law 100.

Let's begin with the question, "What is a Swiss *verein*?" A *verein* is an association of member organizations recognized under Swiss law. It is used to maintain separation among entities under a common

brand. In the legal context, a *verein* is formed through simple articles of association without creation of an entity that actually practices law. Rather, the member law firms independently render legal services and severally accept the rewards and liabilities that accompany such work. They do not share a common profit pool.

Although this is reminiscent of the Articles of Confederation—separate economies, regional constituencies, fragmented decision making—law firms can affiliate with each other as they see fit. When a Swiss *verein* permits a common brand to mask the existence of two or more law firms, however, and single firms are compared to the *verein* firms treated as one, the factual basis for that comparison becomes of more general interest.

In September 2010, the British publication *Legal Week* published an article titled "DLA Piper US and International arms to adopt same strategy." Nearly six years after their purported merger, two firms sharing a brand in a Swiss *verein* began a review of their businesses "which will for the first time see DLA Piper International and DLA Piper US share the same three-year strategy." The review was being led by a U.S. leader, a U.K. leader, and "their respective executive boards."

That the two firms have separate strategies requiring coordination should come as no surprise. After *Legal Week* reported in September

2007 that the two DLAs were putting the “finishing touches” on “full financial integration,” it reported less than a year later that the two DLAs had executed “a U-turn” and in fact had renounced the goal of financial integration. When the music stopped, the *verein* known as DLA Piper was simply a referral arrangement between two firms—DLA Piper US and DLA Piper International.

Although the two DLAs don’t treat themselves as a single economic unit, *The American Lawyer* now does for purposes of The Am Law 100. The basis for this consolidated treatment is unclear. It can’t be that a common brand alone is sufficient, or The Am Law 100 would include another international referral society, Lex Mundi. Extending this logic further, law firms pursuing a “best friends” arrangement could simply slap a label on their cooperative structure and create a new brand, thereby vaulting up the Am Law 100’s gross revenue rankings. Once *The American Lawyer* permits inclusion of *vereins* and other confederations that do not share a single profit pool, it’s difficult to discern a coherent limiting principle. *The American Lawyer* offers none.

What about Hogan Lovells? The legacy Hogan & Hartson and Lovells partnerships benefit from consolidated treatment in The Am Law 100 under their *verein*’s brand. This is a “Noah’s Ark merger”—two of everything. Two CEOs, partnerships, profit pools, accounting years, operations centers, etc. They say that their goal is eventually to integrate. But will they? It’s more likely that they will come to understand, as did the two DLAs, that *vereins* ossify differences among law firms; they do not facilitate their elimination. I suspect the same will be true of other recently created *vereins*—Norton Rose, SNR Denton, and Squire Sanders & Dempsey.

Perhaps the most vivid illustration of *The American Lawyer*’s mistake is the oldest *verein* in the legal industry—Baker & McKenzie. According to this magazine, it’s vying with the two DLAs as the world’s largest law firm as measured by lawyer head count. Yet last September, when the São Paulo division of the

Brazilian bar issued a sharply worded advisory (subsequently affirmed on February 25, 2011) that affiliation between international firms and Brazilian firms could involve the international firm in the unauthorized practice of law in Brazil, reports immediately identified certain international firms as in the regulator’s spotlight [*Latin Lawyer*, September 21, 2010]. Curiously, Baker & McKenzie was not identified, even

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though its worldwide chairman, a member of the Brazilian bar, is the former managing partner of its Brazilian offices and the firm says that it has been practicing in Brazil for over 50 years.

Could this be because Baker & McKenzie purports to operate in Brazil but only through an independent firm called Trench, Rossi e Watanabe Advogados? The head of the association of Brazilian law firms, CESA, must think so. He characterized the bar’s report this way: “The issue here is one of the independence of Brazilian law firms” [*Latin Lawyer*, September 21, 2010]. Trench, Rossi e Watanabe Advogados apparently meets this test. As for the chairman of Baker & McKenzie, I note that the chair of Lex Mundi is located in the Netherlands. Such positions don’t transform a global referral society into a single law firm in the Netherlands, Brazil, or anywhere else.

In its affirmance on February 25, the appellate tribunal of the Brazilian bar’s São Paulo division stated (in translation) that “it is not possible to allow *any financial . . . cooperation* between domestic and foreign law firms [as this] would eliminate the independence that is crucial to the practice of law [in Brazil]. . . .” (Emphasis added.) Clearly, the Brazilian bar knows a law firm when it sees one, and it doesn’t see one when it looks at the *verein* called Baker & McKenzie. Nevertheless, without any principled explanation, *The American Lawyer* treats Baker &

McKenzie as a single economic unit and includes within it independent law firms such as Trench, Rossi e Watanabe Advogados.

Apologists for the *verein* offer various reasons for its introduction into the legal culture. It is, for example, a way of limiting liability. So is LLP status. If two firms employ a *verein* when LLP status is available, we know that limitation of liability was not the driver.

Some apologists seek comfort from the fact that the Big Four accounting firms are *vereins*. In fact, three of the Big Four are not *vereins*, and the single *verein* has recently seen the merger of a number of its international entities. More to the point, here’s what a federal court said about Deloitte’s Swiss *verein*:

“It is well recognized that ‘[m]ember firms in an international accounting association are not part of a single firm and are neither agents nor partners of other member firms simply by virtue of using the same brand name.’ ” *In re Royal Abold N.V. Securities & ERISA Litigation*, 351 F.Supp.2d 334, 385 n.41 (D.Md., 2004) (quoting *Nuevo Mundo Holdings v. PricewaterhouseCoopers LLP*, 2004 WL 112948, *3 (S.D.N.Y. Jan.22, 2004)).

The court held that, “despite plaintiffs’ arguments to the contrary, Deloitte U.S. and Deloitte Netherlands are legally distinct, autonomous firms and will be treated as such.” *The American Lawyer* apparently would have reached a different result. Deloitte, incidentally, has since abandoned its *verein* structure [*The Guardian*, September 20, 2010]. Enough said about instruction drawn from the Big Four.

What about the vexing tax, regulatory, and accounting issues of the U.S., U.K., and other legal regimes that are said vastly to complicate global expansion? What about them? If you have the will to create a single law firm partnership when you combine firms, you retain leading advisers, work your way through the complications, and get the deal done the right way.

Many jurisdictions around the world do indeed require separate juridical entities in

order to practice law, as some *verein* apologists have pointed out. But such local requirements typically do not preclude equity participation in another, common legal entity as well. When law firms avoid financial integration and common ownership even where permitted by local law, you're dealing with firms that wish to simulate rather than to combine as a global law firm.

To be sure, variations in tax treatment create complications, and the reconciliation of accounting systems and fiscal years can cause a one-time financial hit to combining law firms. Some embrace these circumstances and bind their partners together in a single firm. Others avoid them and describe these factors as insuperable barriers to partnership in a single firm. The latter firms see a global vision, but their global plan is a referral arrangement. They are entitled to make this choice. But they are not a single law firm.

Quite apart from merger scenarios, leading U.S. and U.K. firms have developed substantial international networks. Shouldn't they view *vereins* as a desirable step for all of the reasons advanced by the *verein* apologists? Let's do a reality check. Will Latham organize as a *verein*? Based on nothing but intuition, I would say unlikely. Skadden? I have an active imagination and can see the Pirates winning the pennant, but I can't see Skadden as a *verein*. The other "bulge bracket" New York firms? I'm not even sure that they accord the Swiss diplomatic recognition. Jones Day? *Skull and Bones* is a more likely candidate. The Magic Circle? We'll have to look elsewhere for amusement.

Vereins are kaleidoscopic. With spin and mirrors, two or more members can be perceived as one. In fact, they are the antithesis of a single firm and create only the appearance and not the reality of a global law firm. *Vereins* preserve the option of an uncoupled future, and in real time they endorse independence over integration. Indeed, the very virtues ascribed to them—tax and regulatory simplicity, liability protection, financial separation—are virtues of independent law firms.

For law firms whose partners are ambivalent

toward the benefits of a global practice or whose leaders wish not to do the heavy lifting required to become partners in a single firm, *vereins* are one compromise. *Lex Mundi* is another. Neither should be seen within *The Am Law 100*.

The fundamental issue facing the profession, however, is not whether to include *vereins* within *The Am Law 100*. Apart from the hoofers themselves, few really care how many managing partners dance on the head of that pin. Rather, the debate should focus on the principles that favor the traditional "one firm" approach to building a law firm and on whether they have continuing vitality in the age of *vereins*.

All law firms are defined by shared values, goals, and standards. Financial integration

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promotes development of a "one for all, all for one!" culture and supplies a system of incentives and disincentives to ensure that the shared values, goals, and standards are universally observed and their converse avoided.

As one critical example, financial integration allows all incentives to be geared toward the institutional goal of seamless client service. Because all contributing ships rise with the common tide, collaboration ranks atop the pantheon of firm values. Partners, offices, and practice groups a half-planet away are joined at the financial hip, and the most obdurate among them can see, or can be made to see, the benefits to both clients and firm of collaboration and the sharing of opportunities, relationships, benefits, and risks.

A *verein*, by contrast, sees the geographic reach of its brand as an end in itself. Financial integration is a detail to be dispensed with when it's too hard to achieve. Yet this detail—which allows for the incentivization of a fully integrated partnership to follow and serve client interests around the globe—is the engine of a

collaborative, client-focused global expansion. If the inclusion of *vereins* within *The Am Law 100* takes on any broader significance, it is that the magazine now validates a questionable shortcut to client-focused growth. This cannot be good for our profession.

All of which invites the question: Do clients really care about a law firm's structure? Most don't care whether *vereins* are listed within *The Am Law 100*, I'm sure, but they do care about the efficient delivery of properly supervised and coordinated legal services. As one commentator has observed [Mark Brandon, "Verein today, gone tomorrow?," *motivelegal.com*, July 13, 2010], clients express their views through purchasing habits, and this doesn't bode well for *vereins* in a globalized economy. "[M]anaging transactions across the *verein*'s profit borders," he maintains, "will be more difficult than in a 'one firm' organization." If a client desires the seamlessness, efficiency, and cross-border oversight of a single law firm, he concludes, excellent alternatives exist within the global marketplace for legal services.

As always, clients will have the last word.

In these pages in March, Peter Martyr of the Norton Rose *verein* dismissed my perspective as "extremely old-fashioned thinking." I'm nevertheless comforted that his countrymen at *Legal Business* recently described K&L Gates as "The Global 100's fastest growing firm" and that *The American Lawyer* itself ranked K&L Gates first among all Global 100 firms in its Recession Performance Index, 2007–09.

Old-fashioned? Perhaps.

Moribund? Not quite yet.

The legal profession can meet both the demands of the globalized market of the twenty-first century and the expectations of its stakeholders without resort to a construct—the Swiss *verein*—of which Potemkin himself would be proud. For many firms, my own included, it's a simple matter of back to the future.

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