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ALL THE WAY WITH PETER K: INSIDE MIDDLETONS' AMERICAN REVOLUTION



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BULL AT THE GATES

THE MIDDLETONS/K&L GATES MERGER IS RAISING SOME PROVOCATIVE NEW QUESTIONS ABOUT MID-MARKET PRACTICE, AS WELL AS FINALLY CLOSING SOME OLD WOUNDS FOR MIDDLETONS. K&L GATES GLOBAL MANAGING PARTNER PETER KALIS AND AUSTRALIAN MANAGING PARTNER NICK NICHOLA SHARE THEIR STORY WITH ALB. **ANALYSIS: RENU PRASAD**

Of all the mergers which have taken place in the Australian market, the K&L Gates/Middletons tie up has been something of a curiosity. K&L Gates is a firm with a Pittsburgh heritage and is one of the few U.S. firms to invest in an Australian presence. That is novel in itself. But when they did arrive to scout around for an Australian partner, they chose..... Middletons. This was not a merger that many would have predicted. How does a firm which only last year was still marketing itself as part of the Australian "mid-market elite" fit into the global picture? How does it fit into the global ambitions of K&L Gates?

Fortunately, K&L Gates chairman and global managing partner Peter Kalis was recently in town to help explain the merger. Tough, astute and with a sharp turn of phrase, Kalis is one of the more

recognisable figures of the globalised profession. Having led K&L Gates through eight mergers, he's a seasoned veteran of the process and knows what he wants from a partner firm.

It all starts with that crucial merger issue: financial integration. Kalis has been an outspoken critic of non-integrated mergers and once famously referred to them as "Noah's Ark" arrangements whereby duplicate structures and CEOs are brought aboard two by two and expected to operate under a single flag. None of that at K&L Gates, where Middletons appears to have achieved something no comparable rival in this market can claim: full financial integration from day one. No deferred partner vote. No staged transition of remuneration schemes. Just one system right from the start.

"We have a single profit pool, a unitary compensation approach, a single technology platform and a single brand. There is no reason why these things can't occur on day one," says Kalis. He says the firms were assisted by the fact that they already shared a similar performance-based approach to remuneration. "It's a merit based approach," says Kalis. "It wasn't controversial at all – we had similar systems to start with so it was no big deal. It was not like having lock step in Firm A and merit based in Firm B; that would be pulling teeth."

"WELL THE TRUTH WAS WE SPENT 10 YEARS DRIFTING APART. SURE, WE HAD THE SAME BRANDS, STANDARD DOCUMENTATION, BUT IN ANOTHER WAY OUR APPROACHES WERE ENTIRELY DIFFERENT."



Peter Kalis (left) and Nick Nichola (right), K&L Gates

INTEGRATE OR PERISH

Financial integration is something close to the heart of K&L Gates Australia managing partner Nick Nichola. Indeed, by entering an integrated merger with K&L Gates, Middletons was upholding one of the longest and most deeply embedded principles in the firm: an unwavering belief that mergers can only work with full financial integration. It's worth taking a quick history lesson to understand why.

Middletons spent 10 years as a non-integrated firm back in the 1990s – or a “national federation” as such firms were known at the time – and many of the lawyers from that era are still on board to tell the tale. According to Nichola, it was not a successful arrangement. “I was a corporate partner based in Melbourne in those days,” he recalls, “So if I had a client on the phone asking for advice on a deal in Sydney, I’d immediately start thinking about flights up to Sydney and hotel rooms and how it was going to affect my plans with the family. [The federation] just did not facilitate collaboration because we were all operating in different silos.”

This story has a sting in the tail for those firms who have entered merger agreements but have deferred full integration, believing they can revisit the issue down the track. Nichola’s experience is that the longer a firm spends as a federation, the harder it is to fully

integrate. “We thought back in 1992 that we could have a common name, separate partnerships and over the next few years the way we did things would gradually drift into alignment,” he says. “Well the truth was we spent 10 years drifting apart. Sure, we had the same brands, standard documentation, but in another way our approaches were entirely different.” The differences between the groups proved to be irreconcilable and the federation split up. Nichola and his colleagues in Melbourne were left with the Middletons brand and a plan to rebuild the firm to a national practice – but this time they would do things the right way. “In January 2002 we began to rebuild – and we resolved that we would insist on any future merger being fully financially integrated,” concluded Nichola.

In K&L Gates, Middletons have therefore found something of kindred spirit and the resulting merger is what Kalis describes as the legal industry’s largest global integrated network of offices. “30 percent of our revenues are derived from cross-office [referrals],” he says. “No other firm can match that and it arises from a reward system that incentivises [a team culture].”

Kalis is in disputed territory here and the claim to being the world’s largest firm or the largest integrated firm or variants thereof have been made by many in recent years. While firms such as Baker & McKenzie are well known for their use of *verein* structures, many UK firms have preferred full financial integration. However, Kalis does not see these firms as truly global firms in the manner of K&L Gates.

“That’s all hub and spokes stuff, all roads lead to London,” he says of the UK firms. “So you take their managing partner or the senior partner, they’re always in London or the head of M&A or the head of disputes – these folks are always in London. So really it’s a hub and spokes kind of approach.”

It is true that many UK firms have introduced outsiders into senior roles – for example, Australia’s Gavin Bell serves as joint CEO of Herbert Smith Freehills – but Kalis is making a deeper point in relation to the distribution of power in these organisations.

“We’re not organised [in a hierarchy],” he says. “Every one of our offices has equal station and dignity regardless of size.

That's how we think the world is in the 21st Century. In our governance system, each office has someone with the vote and the same information as I have. If I get my way, it's because my ideas are better, it's not because of who I am. It's an idea driven governance culture. Nothing empowers people like knowing that their ideas matter. You might be from Pluto but if you have a good idea, it should prevail in the marketplace of ideas."

MID MARKET

Where does the mid-market fit in the context of the globalisation of the legal services industry? Does it fit at all? After all, the big name mergers of the past year have all involved firms at the premium end of the market.

But Kalis has no reservations about pursuing the mid-market and is proud to point out that K&L Gates was recently named "Law Firm of the Year" in *Mergers & Acquisitions* magazine's M&A Mid-Market Awards. But is Kalis happy to be lumped into the mid-market category? "Absolutely," he says. "You want to know who won it the year before? Skadden. And the year before that? Sullivan & Cromwell."

Kalis defines "mid market" deals as those in the \$25 million to \$500 million space, which he says creates plenty of scope for high value, sophisticated deals which no firm is likely to turn down. "There are not enough gigantic deals to keep everyone busy," he states. "Do you think in this market the Wall St firms or the Magic Circle firms would turn down \$200 million deals? I don't think so. There aren't enough deals to keep people busy, so you bet that they're dropping their deal value. They might want you to believe they're not, but it's simply not true. They're chasing them down, they're doing unbelievable fee arrangements. There's still a certain amount of snobbery about the mid-market, but let me just say that the last five years have humbled a lot of snobs."

Perhaps in Australia, there is a tendency to view "mid-market" as those deals towards the lower end of the \$25 million to \$500 million scale. Still, the general point about deal snobbery may hold true. "If you're insecure about your place in the world, you



probably buy a slightly more expensive car than you should so people see it in the driveway," says Kalis. "A firm might say we only do the humongous deals but in point of fact since 2008 the deal flow has been erratic and reduced. Everyone knows that. Law firms have to be extremely guarded about what deals they deflect away."

Kalis believes the distinction between mid-market and blue chip clients is starting to blur, at least in terms of what kind of legal advice is required. While the very large corporates are more likely to need assistance with cross-border work more often, Kalis points out that medium sized businesses are also increasingly heading offshore.

"Where I'm from we have companies that have \$200 million in sales that have JVs in China," he says. "Now that's because if people are going to invade their local market, they're going to have to position themselves more globally just as a matter of survival. So a lot of these distinctions are breaking down – if you're trying to build a business you cannot typically ignore what is happening around the world. From a legal requirements standpoint the top tier and mid tiers are blurring."

Clearly "mid-market" is a term which can have multiple meanings in different markets. Still, Kalis raises the interesting possibility of a new tranche of global mergers at the mid-market level, a level which is only now progressing towards national consolidation in Australia. Why stop at national boundaries? The next generation of global mid-market firms could be on its way. 