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Capital Markets: Those Who Can and Cannot Do the Purest Global Law Markets

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Abstract

This paper analyses the probability that multidisciplinary partnerships (MDPs) between law and other types of firms may become major players in the market for worldwide capital growth and development. It argues that a key ingredient for reducing risk and complexity in capital markets work is trust developed among a small number of firms—law firm and investment banks—with extraordinary expertise, experience and enduring relationships. Even if MDPs such as the Big Five accounting firms were to develop these factors at a competitive level, it is unlikely that they will disturb the status quo because of their limited liability, unstable alliances, conflict of interest difficulties, non-uniform standards and organizational characteristics different from those of large law firms.

PROLOGUE

TOWARDS THE END OF the twentieth century three significant events took place in the global legal market that were presaging the globalisation of law. The American Bar Association's commission on multidisciplinary partnerships (MDPs) and fee-sharing between lawyers and non-lawyers recommended that MDPs should be allowed (*The Lawyer*, 1999a: 4; *The Law Society's Gazette*, 1999, 8; Kemeny, 1999a: 11).[1] The Law Society of England and Wales recommended that MDPs should be permitted (Hickman, 1999: 2)[2]

[1] At the ABA Annual Meeting in New York in 2000 the House of Delegates, by a 75% to 25% vote, decided to oppose the introduction of MDPs (Williams, 2000: 18).

[2] The Law Society has agreed to speed up its MDP procedures, called Legal Practice Plus. They do not represent fully joined-up MDPs, since they keep the central authority of the firm with the lawyers. *The Lawyer* (2000a) commented: Nick Holt, managing partner at KLegal, welcomes the move. "But it's only part of the proposals, and we want to reach the point of linked partnerships", he says. "I see this as being more relevant to the high-street firm than to the more corporate-orientated practice". One source says the new proposals are akin to the Law Society saying: "We don't mind MDPs so long as we can continue to boss you around".

and, although the Department of Trade and Industry (DTI) thought they should start in 2000, the Law Society expects it will take time before they appear (*The Lawyer*, 1998a: 1). The third event was slightly different: Clifford Chance, the UK's largest law firm, and Rogers & Wells, a well-known New York law firm, decided to merge in the first transatlantic big law firm merger (Barrett, 1999: 3).[3] Two contrary events, but of lesser significance, also occurred. The DTI duplicated the Securities and Exchange Commission's (SEC) ruling that audit firms (i.e., the Big Five), cannot follow Goldman Sachs, the investment bank, and list themselves on the stock market: auditor independence is paramount and could be undermined (*Accountancy Age*, 1999a: 1).[4] Secondly, the Conseil Nationale des Barreux voted to prohibit lawyers from working with, and thus sharing fees with, business consultants, that is, the French bar rejected MDPs (Callister, 1999: 1).[5] Multidisciplinary practice was, therefore, soon to enter the global market for professional services, especially legal services. The magnitude of these changes in the landscape of global lawyering will be of the same order as the transformation of the English landed estates under the hands of Capability Brown.[6]

We are certainly aware that globalisation, as a concept, is coming of age (cf. Held *et al.*, 1999). For example, the 1999 BBC Reith lectures were given by the director of the London School of Economics, and "Third Way guru" to the British prime minister, Anthony Giddens. His lectures, entitled *Runaway World*, attempted to demonstrate how institutions that we have come to take for granted on a local basis—for example, family, education, welfare, culture—are being radically reconstructed in ways that are not always within the clasp of domestic governments or nations. By way of illustration, we could conceive of charitable tax concessions to Canadian ballet companies that could

[3] This has now become a three-way merger with the addition of a German law firm, Pünder Volhard Weber & Axster, but it failed to become a four-way merger with the Australian firm Mallesons Stephen Jaques (Townsend, 1999: 1). Since the announcement of the Clifford Chance–Rogers & Wells merger, there has been a further transatlantic merger, that of Salans Hertzfeld Heilbronn HRK and Christy & Viener (Hoult and Zaki, 1999: 1). In June 2000 there was another full-blown merger between Titmuss Sainer Dechert, London, and Dechert Price & Rhoads, Philadelphia. Before this the two firms had been loosely allied (Tagliabue, 2000: 9). There was an abortive merger attempt between Warner Cranston and Sonnenschein, but Sonnenschein decided to close its London office completely (Farrell, 1999b: 10).

[4] The Big Five have been reprimanded for flouting share ownership regulations. PwC has been admonished by AICPA, the US accounting main professional body, for holding shares in public companies audited by the firm (Michaels, 2000).

[5] The Law Society of Upper Canada has lifted objections to MDPs (*The Lawyer*, 1998b). Victoria, Australia is set to do the same (*The Lawyer*, 1998c), and the New Zealand bar will probably follow suit (NZ Law Society, 1999). The Isle of Man Law Society has voted to relax its rules forbidding MDPs (Blass, 1997). Several European countries explicitly permit MDPs, that is, Germany, Finland, the Netherlands (in part: notaries, patent agents and tax advisors), some cantons in Switzerland (CCBE, 1996). The Netherlands has, however, has determined it will not allow full-scale MDPs, thus precipitating an appeal to the European Court (Laferla, 1999: 22; *Accountancy Age*, 1999b: 3; Swallow, 1999: 2).

[6] Lancelot "Capability" Brown (1716–1783) was a radical landscape gardener who redesigned about 200 large country gardens in England, converting them from the formal French Versailles form to a naturalistic, informal park style.

be equivalent to subsidies under North American Free Trade Area (NAFTA) rules and therefore illegitimate: at some stage it will be impossible *not* to consume genetically modified foods because price differentials between genetically modified food and non-GM products will prevent producers from continuing to use the latter, despite World Trade Organisation rules.

Leaving aside objections to globalisation by such sceptics as Hirst and Thompson (1996), global politics and economy are being driven ineluctably towards a new domain not circumscribed by the usual array of constraints.[7] A combination of governments, especially the USA, the Group of Seven, multinational enterprises, and international governmental organisations (IGOs), sometimes collectively known as the "Washington consensus", are redrawing the global map.[8] Although hyperglobalisers, such as Kenichi Ohmae (1991, 1995), would argue that we are entering the borderless world, it is worth observing, however, that major trade and investment flows are not truly global. The vast bulk of foreign direct investment stock moves between North America, the European Union and Japan (UNCTAD, 1995; Held *et al.*, 1999: 242–55).[9]

What we perceive as globalisation may be interpreted as particular world regions interacting financially in defiance of diurnal rhythms to enhance global capital, which may eventually lead to greater globalisation. Nevertheless, for globalisation to function as a "system" it needs the intermediation and support of institutions to transform the apparent to the real (see Shapiro, 1993). Many of these will be professional service firms similar to accounting firms (for example, PricewaterhouseCoopers), consulting firms (for example, McKinsey), investment banks (Goldman Sachs), and law firms (for example, Clifford Chance), but their interaction can be problematic. Professionals from different groups have diverse cultures and ideologies. In the UK, law and accounting have struggled over status differences for close to two centuries (Abbott, 1988). Yet both are undergoing profound changes that render old ideologies potentially obsolete. Capital growth and development ideally require interaction that is unfettered by hidebound tradition, which is how international capital markets are trying to grow. But each profession has been fighting rearguard actions to prevent others making incursions on its own turf. The use of unauthorised practice rules by state bars in the USA against the Big Five accounting firms is a classic example of turf wars.

Thus at a public level there is a veneer of co-operation while beneath opposition is strong. Unless this suggests that, absent restrictions, the professional world would be a ferment of competitive struggle, one should be aware that certain kinds of work tend to be restricted to small, elite groups, partly as a result

[7] I am not particularly concerned with the cultural aspects of globalisation here. See, e.g., Robertson (1992), Flood (1995).

[8] The war against Serbia is a case in point where NATO has attempted to redefine the international law of war, that such wars can be instigated without the sanction of the UN Security Council. See also the role of nongovernmental organisations (Hobe, 1997).

[9] In 1993 World inward FDI stock was greater than $2,000 billion (UNCTAD, 1995).

of tradition and also because of the steep learning curve inherent in the nature of the work. The barriers to entry are usually high. Two types of work, for example, that are buffered this way are international insolvency (see Flood and Skordaki, 1997); and capital markets work. Illustrations given below will highlight the "bespoke approach" of capital markets work: but it merits mentioning the view of the head of investment banking at Goldman Sachs when he says, "[t]he nature of [big mergers and acquisitions] means that there is no template to refer to. It is often the first time, leading to a premium on expertise and experience."[10]

A cardinal point of global commerce is capital markets work. And, naturally, it possesses its own legal practice. Hodgart claims (1999: 6), "[n]o legal service is more globally driven than finance and, within this, capital markets work is the 'purest' global service". Indeed, one could argue that capital markets work is constituting a *jus communis*. To provide some idea of the scale of the work, in 1998 the six largest mergers and acquisitions amounted to over $300 billion and were funded by a combination of equity and debt issues (Hodgart, 1999: 6). Two legal products dominate this field: New York state law and UK law (Flood, 1996).[11] Dignan (1999a) points out that "[i]n a banking transaction, such as the Olivetti and Telecom Italia deal, the senior debt will often come under English law, while the high-yield will go through US law, but the sourcing may come the Continent. Therefore, only those firms with UK, US and European capability will be attractive to clients". The service is global but the products are local.[12] Any major privatisation, for example, will have to include the issue of shares on the New York and London stock exchanges, therefore all documentation will be reviewed and cleared with their respective regulators (see Neate, 1987: 56–94). The fascinating aspect of this is the interaction of the structural developments of professional service firms, their desire for global reach, and the structure of capital markets work, that is, the nexus of organisation and work (Flood, 1996, 1999a).

This story is composed of three parts. I will first discuss the structure of and actors in the capital markets business, attempting to explain what is special about this type of work. Because the number of actors is small and their social density high, I will argue that a key concept for decreasing risk and reducing

[10] The uniqueness of big M&A deals is growing as they get bigger and bigger. In 1999 MCI WorldCom moved to acquire Sprint Corp for $127bn (Rivlin and Silverman, 2000: 9), and in 2000 Vodafone arranged a merger with Mannesmann to create the world's biggest telecom company worth £225bn (Gow, 2000: 32).

[11] This is the reason why in my introductory paragraph the "big events" I refer to are North American and British. Other legal systems are not in the same league as the big two. Some disagree with the notion that New York state law is the dominant American legal force; instead they claim that Delaware law or SEC law is the paradigmatic feature of capital markets work. I am grateful to Rob Rosen for suggesting these alternatives.

[12] Cf. the view of the City of London Law Society in 1989, "[t]he advantages of English law as a 'product' enable solicitors to contribute to this country's balance of payments some £250,000,000 per annum in invisible exports and constitute an important part of the attraction of the City of London as a world financial and insurance centre" (1989: 5).

complexity is high-density trust which encourages compliance among agents (Luhmann, 1979; Bachmann, 1999). If the market is opened up, either the scope of regulation may have to be increased at significant cost for compliance and/or the relationships in the business may become increasingly formalised. Central to the correct functioning of the market is the ability of a small number of law firms and investment banks to provide high levels of expert knowledge within tight time constraints. The law firms require access to the best law graduates (Flood, 1999b) and generally have strong, enduring relationships with large investment banks even though the work is transactional. Secondly, I will examine the nature of MDPs, especially the evolving relationship between lawyers and accountants—the most obvious tie-up in the corporate world. These appear to be the archetypes of a new global professional service firm that ought to be capable of delivering any combination of services anywhere. Thirdly, I attempt to show how MDPs, although apparently repositories of considerable expertise, will not be the most successful vehicle for elite global work such as capital markets. This is not to say that MDPs, or variants of them, will not be able to evolve to take on this work; their relationships with investment banks might evolve a similar concentration to those of elite law firms.

PART I: CAPITAL MARKETS BUSINESS

Corporate finance is crucial to global practice for large law firms. For example, within the City of London the Big Five, or Magic Circle, law firms dominate this field—their market penetration of major corporate and financial institutions is between 25 and 33 per cent, and they have a disproportionate share of FTSE 100 clients (Marks and Griffiths, 1997: 26).[13] In the USA a similarly small number of New York law firms, the Wall Street firms (Barnard, 2000: 1), are consistent repeat players in capital markets work, all of which have a large stock of Fortune 500 companies as regular clients (International Centre for Commercial Law, 1999a, 1999b; see also Silver, 2000).[14] This concentration of expertise is also found in the investment banks, the other side of the equation here, where seven banks tend to dominate this work and all are US based. Hodgart (1999: 6) notes, "three investment banks dominated the global adviser market in 1998, handling $2.23 billion of deals, with the next three banks handling $1.18 billion. Within the US the three leading firms (the same as worldwide) handled $1.2 billion compared with the next three banks with $690 million".

[13] The Big Five law firms are Allen & Overy, Clifford Chance, Freshfields, Linklaters, and Slaughter and May (Marks and Griffiths, 1997: 26).

[14] The key US law firms, in no particular order, seem to be Brown & Wood, Simpson Thacher & Bartlett, Weil Gotshal & Manges, Davis Polk & Wardwell, Sullivan & Cromwell, Shearman & Sterling, Cleary Gottlieb Steen & Hamilton, Cravath Swaine & Moore, White & Case, Baker & McKenzie, Fried Frank Harris Shriver & Jacobson, Milbank Tweed Hadley & McCloy, Coudert Brothers, Wachtell Lipton Rosesn & Katz, and Skadden Arps Slate Meagher & Flom.

By 1999 the big three investment banks, Goldman Sachs, Morgan Stanley Dean Witter, and Merrill Lynch, had "each advised on more than $1 trillion in world-wide mergers and acquisitions" (Deogun, 2000: 13). The value of the deals also indicates the rewards to the investment banks and others who participate in capital markets work. At the end of 1999 dozens of managing directors (formerly partners) of Goldman Sachs received $10 million or more in salary (Garfield, 1999: 13). What is clear about this sector is that the critically decisive players are few in number and their networks are densely structured, encouraging repeat-player patterns of activity.[15] Ferguson (1997: 33) spells out the connections:

> A small band of major banks call the shots on the big-ticket equities issues. These are the people to impress for law firms looking to develop market share on these deals. Unfortunately for the pretenders, the banks sit comfortably alongside a similarly small band of law firms. On Wall Street, relationships extend beyond even the eldest partners, and banks and firms share a lineage steeped in the history of New York's development as a financial centre. Some of these old-school ties are part of Wall Street folk law [*sic*]: Goldman Sachs and Sullivan & Cromwell, Morgan Stanley and Davis Polk & Wardwell.

For example, the relationship between Morgan Stanley and Davis Polk goes back 110 years (Forster, 1997: 37). If we take some of the key investment banks and match them with a sample of their legal advisers the patterns become evident. Table 8.1 illustrates this.[16]

Capital markets work embraces a number of types of activity: for example, privatisations, initial public offerings (IPOs), securitisations, asset and derivative backed issues, and depositary receipt programmes. As I mentioned earlier, New York and English law predominate in these markets. For example, in the Olivetti and Telecom Italia merger, the senior debt came under English law while the high-yield debt went through US law (*The Lawyer*, 1999e). But their competitive edges never remain sharp for long. The complexity of the British Gas issue has been attenuated with the SEC's introduction of Rule 144A,[17] which allows foreign issuers access to American institutions in the USA without

[15] I have found only two references to collaboration between investment banks and/or law firms and accounting firms. Linklaters & Alliance were advisers with KPMG to the Mozal SARL (Mozambique) project worth $1.34 billion for a power plant and aluminium facility (IFLR, 1999: 22). Merrill Lynch was part of a consortium with Coopers & Lybrand advised by Skadden Arps for the restructuring and privatisation of the Telephone Organisation of Thailand (Skadden Arps, 1999: 2). Kemeny (1999b: 8) argues, however, that the Big Five are poised to take "a bigger slice of corporate finance deals" whereas "[o]nly a few years ago, it would have been inconceivable for an accountancy firm to be advising on deals of between £20m and £200m. Last year, KPMG advised on 423 deals, while PwC advised on 415, although PwC's deals were worth more in volume."

[16] These samples were derived from LawMoney.com. Within a given year, it is fair to see a preponderance of US law firms involved as legal advisers to the major player investment banks.

[17] The SEC is further revising its rules on cross-border M&As to encourage non-US companies not to exclude US investors because of the difficulty in complying with the former registration requirements (Brown, Bird and Kiernan, 1999).

Table 8.1 Major Investment Banks and Legal Advisers

INVESTMENT BANK	LAW FIRM
Merrill Lynch	Brown & Wood (*New York*) Cravath Swaine & Moore (*New York*) Davis Polk & Wardwell (*New York*) Freshfields (*London*) Skadden Arps (*New York*)
Crédit Suisse First Boston	Allen & Overy (*London*) Clifford Chance (*London*) Cravath Swaine & Moore (*New York*) Davis Polk & Wardwell (*New York*) Shearman & Sterling (*New York*) Simpson Thacher & Bartlett (*New York*) Skadden Arps (*New York*) Weil Gotshal & Manges (*New York*)
Goldman Sachs	Allen & Overy (*London*) Cleary Gottlieb (*New York*) Cravath Swaine & Moore (*New York*) Davis Polk & Wardwell (*New York*) Freshfields (*London*) Sullivan & Cromwell (*New York*)
Morgan Stanley	Brown & Wood (*New York*) Davis Polk & Wardwell (*New York*) Freshfields (*London*) Shearman & Sterling (*New York*) Weil Gotshal & Manges (*New York*)

the burdens of SEC registration (Forster, 1996: 17).[18] This has enabled English law firms to enter the US private placement market, although registered offerings still remain in the US law firms' bailiwick. The growth of the global depositary receipt (GDR) market also shows how competition is spurred. A commentator said:

> In the early days of the GDR equity market, the US firms got hired because they could do the disclosure and depositary agreement under New York law and the UK firms seemed to sense a competitive disadvantage. There were a lot of deals where English firms would write the prospectus with the underwriter. . . . But English lawyers and

[18] Rule 144A entails considerably less due diligence than a registration and incurs less costs. Registration meant many Asian businesses, for example, were averse to coming to the American market (Forster, 1997: 36). SEC Regulation S is the corollary of Rule 144A allowing American investors to buy non-registered stock offshore (Forster, 1996). In the days of the British Gas privatisation, the SEC required the issuers to block any advertising of the stock appearing in the American press (Neate, 1987). With the Internet, this would now be impossible.

> Linklaters & Paines in particular wanted to develop the GDR market and to establish a way putting a second certificate in Europe. . . . Linklaters has been developing this market so issuers do not have to use US lawyers. Often even when the US side is small its requirements tend to predominate and a lot of this is trying to say that US investors can invest in Europe . . . It was one way to keep out the US lawyers . . . [Forster, 1996: 22].[19]

That New York law firms have the competitive advantage over UK law firms is put down to them being "exporters of legal technology adapted for local markets by those firms that have the touch which entices a particular client to work with them" (Forster, 1997: 37).[20] A counter arguments says that as the banks become truly global, the US law firms have failed to keep up, which is beginning to loosen traditional ties and open the market for other lawyers.

Two examples of capital markets work will illuminate the role these institutions play. The first is a major international initial public offering (IPO), and the second example involved a large project financing in Russia.

Example 1: Alstom (1998)

In 1998 the largest non-privatisation IPO was a French company, Alstom, amounting to $3.7 billion. Alstom was owned equally by GEC of the UK and Alcatel of France. It had over 400 subsidiaries in over 60 jurisdictions and was registered as a Dutch NV. Among the advisers the global co-ordinators were Goldman Sachs and Crédit Suisse First Boston, and their advisers were Davis Polk & Wardwell and Stibbe Simont Monahan Duhot & Giroux, a "large" French law firm.[21] Acting as counsel to the issuer were Shearman & Sterling and Lovell White Durrant. And, finally, counsel to the selling stockholders were Freshfields and Gide Loyrette Nouel, another "large" French law firm. Before the IPO launched the company's in-house counsel had to take charge of reorganising the company and its various subsidiaries from a Dutch company into a French one. This involved numerous government authorisations, adding to the already complicated and logistically challenging nature of the deal. Preparation for the IPO ran in parallel to the reorganisation and involved French, English, US and international tranches, consisting of a primary offering of shares sold by Alstom and a secondary offering by Alstom's parents. The

[19] During 1999, Linklaters advised on deals in excess of $1 trillion. "The firm says its success has been a result of capitalizing on the trend towards globalization and consolidation across a number of industries" (LawMoney.com, 2000).

[20] Another competitive advantage US law firms have over the UK is the level of their hourly billing rates. E.g. the following per partner billing rates from around the world show the differences: Australia, $200–300; Bermuda, $300–450; Hong Kong, $600–700; UK, $375–575; US, $225–450; Vietnam, $75–100 (Lee, 1997: 24). However, some argue that transaction rates are roughly comparable.

[21] In comparison with the large law firms of the USA and the UK, the "large" law firms of mainland Europe are small.

shares were listed in Paris, London and New York and were subject to full regulatory review simultaneously by the SEC in the USA, the London Stock Exchange in the UK, and the COB in France.

The offering involved the issue of American Depositary Receipts, listed in New York, and the first ever UK Depositary Receipts, listed in London. Lovell White Durrant structured the UKDRs and advised Alstom on its employee share offering, which covered some 35 jurisdictions and ran as part of the public offering. Davis Polk & Wardwell led the due diligence, ensuring that the company's diverse material assets and subsidiaries were intact and included in the deal, or at least making sure that fall-back plans were in place if the reorganisation was not completed by the time of the IPO. The firm also advised on the core disclosure document, the adequacy of the disclosure and the underwriting agreement itself.

Just one month before the closing of the IPO, Alstom acquired Cegelec, an electrical contracting and process control business owned by Alcatel which was itself a quarter of the size of the combined issuer. All the work which had been to demonstrate what the group would look like after the reorganisation was redone taking into account the new business. After five months' work the deal was priced to go (IFLR, 1999: 13).[22]

Example 2: Sakhalin II, Russia (1998)

Sakhalin is an island in Arctic Russia with the Piltun-Astokhskoye oil and gas field lying offshore, which may contain as much as the North Sea reserves. This project is Russia's first offshore oil and gas project with an estimated cost of $9 billion. It is also the first project commissioned under Russia's Power Sharing Agreement Law (PSA) of 1996. The legal advisers were Freshfields, for the lenders, and Coudert Brothers, acting as international counsel for the project company. They faced a number of challenges in negotiating the deal, including coping with multiple layers of national and local regulations along with strict environmental laws. As the first offshore project, it had *to develop local laws* as it progressed. A PSA is a direct agreement between the government and investors on a tax regime that the government guarantees to apply to the project for its entire duration. This enables investors to plan costs more accurately and provides security.

A challenge for Sakhalin II was that only 70 per cent of the necessary legislation was in place to support the PSA. Furthermore, the long-term nature of the project means that the project company will have to negotiate contracts to cope with different groups of lenders over time. This may mean lenders submitting documentation to prevent the project company from borrowing in the future.

[22] In all, in 1998, Davis Polk & Wardwell advised in five major deals: Alstom (France) $3.7 billion, Swisscom (Switzerland) $6.43 billion, Telefonica (Spain) $2.7 billion, Argentaria (Spain) $2.4 billion, and Salzgitter (Germany) $483 million (IFLR 1999: 7).

Although this was avoided in the first stage of Sakhalin, the project has raised the issue and may use such documentation in its second stage. Finally, the deal was completed in spring amidst a deteriorating Russian economy and falling oil prices. The project company, Sakhalin Energy Investment Company, was sponsored by Mitsui, Marathon, Shell, and Mitsubishi. The lenders were the European Bank for Reconstruction and Development, Overseas Private Investment Corporation (US), and the Export-Import Bank of Japan. The first stage of Sakhalin was funded by sponsor equity of $385 million. A further $348 million in debt is being raised. The project is now in jeopardy because of the Russian financial crisis (IFLR, 1999: 23).

Final Remarks

Capital markets work is risky and subject to the whims of the global economy—Asian economic crises, the "Tequila effect" of the Mexican peso crisis, the Russian economic collapse. It is tightly bounded by deadlines, replete with financial contingency, and extremely demanding of bodies of expert knowledge. Competition between advisers is great. Paul Volcker (1999: 11) noted, "[c]ompetition to 'outperform' is intense". The hostile takeover bid for NatWest bank by the Bank of Scotland demonstrated the need for engaging the most suitable experts (Treanor and Brummer, 1999: 28). NatWest hired Roberto Mendoza, "Wall Street's top defender against hostile bids", to reinforce a defence team that included:

> investment bank Dresdner Kleinwort Benson and McKinsey partner Charles Roxburgh, who was a crucial player in the rescue of the Lloyd's of London insurance market. Mr Roxburgh has the confidence of NatWest chairman Sir David Rowland and his new chief operating officer Ron Sandler, his former right-hand man at Lloyd's of London [Treanor and Brummer, 1999: 28].[23]

The competition Paul Volcker refers to is a combination of factors—the urge for global reach, the desire to make the greatest profits, the need to be the biggest and best—where banks' and law firms' motivations overlap, although they are not truly isomorphic. Law firms are considering the one-stop shop or MDP route (see part II below) and banks wish to be perceived as all-embracing one-stop shops for their clients' ambitions. Not only do we see domestic mergers as the Royal Bank of Scotland acquisition of NatWest, but also increasingly banks look overseas for targets, such as Deutsche Bank's takeover of Bankers Trust

[23] McKinsey & Company is a global consulting firm that is usually associated with the hyperglobalisation perspective of globalisation (see Ohmae, 1991: 1995). Ohmae is the senior Tokyo partner for McKinsey. It undertakes considerable research on financial institutions and publishes many books and reports that have caught the popular imagination and helped create the mythological aspects of globalisation, e.g., Rosenthal and Ocampo (1988), Bleeke and Ernst (1992), Casserley (1992), and Bryan with Farrell (1996). This chapter, however, concentrates on the Big Five accounting firms.

(*The Lawyer*, 1999e). Banks want to do both advisory and loan work. Volcker's conception of competition is further intensified when we realise that, as demonstrated above, the big cross-border deals involve the big three of Goldman Sachs, Merrill Lynch and Morgan Stanley. The concentration of market power raises cost of entry for both banks and law firms outside the "magic circle".

One result has been a capacity and willingness to reach out for more exotic, potentially high-yielding investments. The private sectors of emerging economies, with their strong growth potential, have become prime targets. Perhaps the crucial factor here is that the law firms, and the investment banks, are devising the financial and legal maps of the world as they do the work. They are not merely responding to a set of problems that need answers; they are generating the questions and then finding solutions, which at best will always be partial (cf. Tomasic *et al.*, 1996). The institutions, IGOs, investment banks and law firms, through capital markets work, are creating a *global political economy* for the future that will be the engine of their aims for global capital. Because the game is high-risk and, of course, high-yield, there is a reluctance among the players to grant roles to novices and outsiders, which maintains the environment of the game as a hermetically sealed unit, and the rewards of the game are distributed among the few. This serves to suggest that in capital markets work lawyers enjoy a high degree of autonomy that enables them to create and to innovate solutions.[24] It affords them high professional status.

PART II: MULTIDISCIPLINARY PARTNERSHIPS

What happens to the Big Five accounting firms has long mattered to the legal profession but probably never as much as now; the news from the accounting world is news of change, of something happening, of preparations and plans—perhaps of going to war? The Big Five have always characterised themselves as global institutions. Law would be the last component to be added in a strategy of global delivery of professional services.

The Big Five have reorganised. KPMG replaced its traditional regional structure with a nationally run business-sectoral service as part of an ambitious overhaul of its UK practice.[25] Already KPMG has incorporated its audit arm. PricewaterhouseCoopers (PwC) and Ernst & Young have heavily invested in the creation of a Jersey Limited Liability Partnership (LLP) and have already applied for judicial review of the Inland Revenue's ruling that they would be treated as companies if they registered offshore to limit their liability (cf. Sawin, 1999: 20).

[24] I am grateful to Martin Shapiro for suggesting this hypothesis.

[25] KLegal, the legal arm of KPMG, is now undergoing a similar restructuring, splitting into 6 groups comprising consumer markets, financial services, infrastructure and government, industrial markets, owner-managed businesses and information, communications and entertainment (*The Lawyer*, 2000a).

The Big Five have set up firms to operate as their legal arms in the UK. Their experiences on the continent convinced, if not pushed, them to offer legal services in the UK. The associated law firm is a method successfully tried and tested, in Paris and other European capitals. Paris has been particularly important to the Big Five in planning their overall strategies for law firms around the world. Accountants' law firms occupy no fewer than six out of the top nine places by size in France and their fee income totals more than £200 million (Cannon, 1997: 28). The recent history of the Big Five shows that Arthur Andersen was the first, with the establishment of Garrett & Co as a two-partner firm in the summer of 1993. Arnheim & Co was set up by PwC in March 1996. Ernst & Young were widely expected to be the third Big Five firm to set up a legal practice, only to be overtaken by Cooper & Lybrand's (now part of PwC) setting up of Tite & Lewis, a firm fronted by two ex-Stephenson Harwood partners. Deloitte & Touche, with an extensive legal network in several European capital cities, has now opened its law arm. KPMG, with law firms dotted around Europe, the largest being Fidal in France, launched KLegal, which will be a *de facto* MDP (Farrell, 1999a: 3), which it accomplished by poaching lawyers from Arnheim, Tite & Lewis (Quick, 1999: 8).[26] It will not be a stand-alone firm, although it "will have a separate entrance to comply with Law Society regulations" (Farrell, 1999a: 3).[27]

The Big Five's law firms have expanded rapidly. Once established, the accounting law firms have grown beyond recognition. Both Garrett & Co and Arnheim & Co started as greenfield ventures. Yet, after two years, Garrett & Co had 30 partners and 50 assistant solicitors in five UK offices (London, Reading, Birmingham, Leeds and Manchester) and had launched a major advertising campaign to recruit London assistants of talent. Garrett & Co made a further leap forward by acquiring Glasgow-based Dorman Jeffrey & Co, a 14-partner practice with substantial expertise in the insolvency field. Outside the UK Andersen's Spanish legal arm merged with Madrid's largest law firm, J&A Garrigues, to form a practice of over 500 lawyers (Darnhill, 1997: 40). The effect of these mergers was to alter the status of accounting firm lawyers from tax advisers to lawyers *per se*: "[a]ccording to one Spanish lawyer: 'It was a matter of perception. They were not seen as lawyers' " (Cannon, 1997: 27). Arthur Andersen has now more than 1,700 commercial lawyers in worldwide network (see Table 8.2). Arnheim & Co was started by a 35-year old corporate finance ex-Hammond Suddards partner, with plans to have 10 lawyers on board by the end of 1996, which it did, and 50 lawyers within four years, which it has exceeded. Unlike the small practices set up by Arthur Andersen and Price

[26] KPMG has now formed a "strategic alliance" with a large US law firm, Morrison & Foerster, to provide tax advice. This appears to be the first big alliance—to deal with tax issues—between a Big Five accounting firms and a US law firm. PwC is also searching for a US law firm partner (Dignan, 1999b: 7).

[27] One City lawyer has commented on the move: "It's almost a fallback option to be doing a start-up. They are really starting two or three years behind the game" (Farrell, 1999: 3).

Waterhouse, Coopers & Lybrand, as it then was, chose to "hit the ground running". Their firm, Tite & Lewis, immediately slotted into the lower end of City firms with a fee income projected at around £5 million in the first year. Arnheim & Co, Tite & Lewis merged under PwC, but Tite & Lewis soon moved to Ernst & Young (Kemeny, 2000: 10). The PwC chairman's open invitation to City law firms to join PwC in building a legal arm of 3,000 business lawyers in the major centres of the world has given rise to wild speculations of things to come.[28] The first move in this direction has been to incorporate all PwC's law firms under a single brand, "Landwell", which is innocuous in any language, to make the biggest Big Five legal arm yet (Farrell, 1999c: 2). All of these manœuvres have generated a push to create global law firms attached to the Big Five. And the result of these developments is that the Big Five's law firms are now firmly located in the top 50 worldwide law firms. Table 8.2 shows their rankings and size.

Table 8.2 Ranking and Size of Big Five Accounting Law Firms Compared with Law Firms

NAME	TOTAL NUMBER OF LAWYERS	RANK IN IFLR TOP 50 LAW FIRMS*
Clifford Chance/Rogers & Wells/Pünder (London)	2518	1
Baker & McKenzie (Chicago)	2432	2
Landwell (PwC) •	1735	3
Arthur Andersen Legal Services •	1718	4
Skadden Arps Slate Meagher & Flom (New York)	1366	5
Jones Day Reavis & Pogue (Cleveland)	1353	6
KPMG •	1264	7
Sidley & Austin (Chicago)	872	15
Ernst & Young •	954	16
White & Case (New York)	922	17
Blake Dawson Waldron (Sydney)	716	29
Deloitte Touche •	691	30
Fulbright & Jaworski LLP (Houston)	675	31

• represents accounting firms
*IFLR: International Financial Law Review

[28] There are constant rumours around the City of London that X law firm is about to merge with Y of the Big Five.

While statutory prohibition was removed by the Courts and Legal Services Act 1990, it is still technically impossible for accountants to enter into partnerships with solicitors. And there remains ambivalence over the idea (see also Chambers and Parnham, 1996). A survey of finance directors (FDs) (*Accountancy Age*, 1999) found that:

> only 33% of FDs of small and medium-sized businesses . . . said they would hire a lawyer from the same firm that does their audit. Of the 51% who opposed mixed practices, most believed that they would compromise an auditor's duty to offer independent advice . . . [A] respondent, who asked to remain anonymous, said: "I might want to confide my most business secrets to my lawyer. I wouldn't let my auditor in on the act until I had covered my bases".

However, a survey commissioned by the *Financial Times* found that "more than half of the UK and US's big corporate buyers of legal services are willing to use a firm that combines lawyers and accountants" (*The Lawyer*, 1999b: 7).

While MDPs appear to offer economies of scale that should be attractive to producers of business professional services, consumers are unclear about the advantages. Moreover, both the SEC and the DTI have voiced reservations about the threats to independence of auditors by these sorts of interlocks. These reservations have met with support from the New York City Bar Association and the Pennsylvania Bar Association, who agree and disagree respectively with the ABA's proposals on MDPs (*The Lawyer*, 1999c: 7). The Law Society in its consultation paper raised the spectre of conflicts of interest between the lawyer's attorney–client privilege and the auditor's duty to disclose (Law Society, 1998: 18). In fact, this is the recurring theme of opposition against MDPs (e.g., Marson, 1999: 17; Wolfram, 1999; cf. Mullerat, 2000). The plans of the Big Five rest on the provision of legal services across national boundaries, and this strategy has, in the last couple of years, been directed by the most senior management in the Big Five. As the global legal supremo at the former Coopers & Lybrand commented, "London was important for us in order to have an English law capability in the network of [European] offices. Now this is done, we expect to be able to accelerate our progress in integration and service offerings" (Chambers and Parnham, 1996: 18). While the managing partner of Garrett & Co suggested that it was only a matter of time before the Big Five accountancy networks dominated international legal services.

Thirty years ago, accountants were primarily involved in auditing and accounting. Step by step, they have moved into tax, management, consultancy, human resources, information technology and corporate finance. It now appears to be the turn of legal services before the accountant's evolution into a full service professional adviser is complete. Auditing has long been a problematic core activity for the accounting profession. It is of course restricted from outside competition (as a registered and regulated professional activity) but it is nowhere as profitable as other activities and in addition carries huge liability exposure. Auditing's main value is very much as a springboard for offering

other ancillary services to the captive auditing client base. However, this in itself can be problematic; for example, Andersen Worldwide was in the process of sorting out the very public problem of electing its new chief executive. The election had been made impossible by the open hostility shown by Arthur Andersen towards the candidate put forward by Andersen Consulting and the other way round. Ironically, the consulting arm of Andersen Worldwide generated more profits in 1996 than the auditing–accounting sector ($4.9 billion compared to $4.6 billion). The two have now divorced.

Accounting firms consist of component parts in varying stages of development. It is generally agreed that the audit side is mature and so is tax. Consulting is also becoming mature whereas corporate finance and law are still young. The legal services market is particularly attractive because of its size (twice that of the tax market) and its close fit with other areas of practice such as tax, corporate finance work and general corporate law. Furthermore, accounting firms count on their capability to offer legal services themselves as a defence against the competition of growing tax departments of City firms such as Clifford Chance. By adding general legal services to their list of offerings, the Big Five can prepare to meet the challenge of the big City firms in the tax area and their practice of tagging general legal services on to specialist tax advice.

The legal capacity sought by the Big Five can come only from City law firms. In a general environment of expansion, even euphoria, and demand for business legal services, accounting law firms have joined City firms and US firms with a UK presence in the battle to attract suitable lawyers at all levels. This does indicate that the strategies of law firms and accounting firms are diverging. As the European co-ordinator for PwC (and ex-Pinsent & Curtis London managing partner) suggested: "they [the top City firms] are going the same route as us and there is only room for a certain number of players". The recent merger fever among solicitors' firms supports this idea of diverging strategies along the theme of expansion. Also, in the last couple of years there has been a significant change in the extent to which the top City law firms have increased their dominance over other firms, leading to what is known as the "Super Group" of the Big Five (Marks and Griffiths, 1997).

The accounting model for growth, consolidation and geographical coverage appears to have been accepted as the main paradigm of professional practice development. Like accountants, City law firms appear to have recognised that professional services can only follow their clients and what the clients look for is reliable service in many different jurisdictions (cf. Flood, 1996; cf. Silver, 2000). As the UK market for legal services is rather small and static, there is nowhere to expand but overseas. This suits the clients (as long as they do not get asked to meet the cost of expansion) as much as the lawyers and the accountants. Less than that would be sufficient as the basis for building a special relationship.

Lawyers and accountants are striking their different bargains out of their special relationship in accounting legal firms. For the accounting profession the setting up of a legal arm means the opportunity to maximise the work their

auditing client base is put to; to gain access to new types of services; to compete more effectively with other accounting firms but also with City firms (over services already provided by both) and US law firms that currently represent the only other alternative to a truly global practice (cf. Barrett, 1999; Silver, 2000). For the legal profession the main bargain is geographical as well as service and client expansion (undreamed of even among the Super Group of the Big Five) as well as protection. Any alliance with a Big Five firm offers formidable protection against other competition either from within the legal profession (nationally and internationally) or other firms of accountants.

But are lawyers ready to contemplate that they may be finished as a result of their special relationship with accountants? The differences in professional cultures and practices are often exaggerated in that respect. In the legal press, accounting firms are presented as more commercial than law firms and with little admiration or time for individualism (people that work for Arthur Andersen have been nicknamed "Androids"). Along the same lines, partners just do not matter as they are all paid on performance (interestingly, City law firms have in fact been agonising over whether to adopt accounting career and pay structures). Accountants are also said to work less hard. A newly qualified solicitor—used to working long City hours—was told at her second interview with one of the accounting law firms that the accountants (who live on the floor above the lawyers) descend on the lawyers after eight o'clock in the evening to see who is still working—this being a sure sign that the lawyers concerned lack effective working practices. So far, the omens are not good. Arthur Andersen's attempted takeover of Wilde Sapte, a 300-year-old City law firm, ended in public humiliation for the law firm when it was spurned by its suitor for carrying too much deadweight in its partnership (Flood, 1998: 16). However, we should recall that Andersen has taken over Scotland's largest law firm, Dundas & Wilson, and that of Spain, now J & A Garrigues Andersen y Cia (Cannon, 1997: 25; Marcos, 2000).

PART III: BRINGING IT TOGETHER

It is no surprise that the number of players in capital markets work is small. The key variables are size, reputation and status. Law firms, for example, must be able to devote large numbers of staff to critical time-bound projects. When ING bought the liquidated Barings merchant bank, the law firm of Slaughter and May had one weekend to do the work (banks are sensitive creatures when put into play this way): they immediately put 30 lawyers on the project (Fay, 1996). Moreover, these firms must be capable of attracting the best-qualified lawyers to work for them. Remuneration and types and scale of work generated provide magnets for staff.[29]

[29] The extent to which remuneration is a key magnet compared to the bonuses and share options offered by investment banks and dot coms is questionable. It is difficult for law firms, whether American or British, to match these institutions.

The next variable is reputation. It is significant because markets for expert knowledge tend to be small and sustained through relatively stable memberships or networks of ties. These memberships are socially structured and depend on developing trust and order (Granovetter, 1985; Baker, 1990; Webb and Nicolson, 2000). Reputation, therefore, plays a considerable role, as Leifer (1985: 443) indicates: "[a] small and identifiable group of producers, attached to brands, develop stable and distinct reputations among consumers and hold onto stable market (volume) shares. The reputations are not arbitrarily distributed across producers, but are often tied to market share". This is very much the situation with the magic circles of investment banks and law firms, for example, Goldman Sachs and Sullivan & Cromwell. It is virtually impossible for an outsider to breach these barriers. Those that have managed it have done so by indirect means.[30]

One further element is implicated in the configuration of these professional markets, namely, the effect of status as perceived by producers and consumers. Since reputations are unevenly and unequally distributed, perceived differences in quality frequently result in high-status producers receiving more customers than low-status producers, despite the quality of service rendered. Likewise, the business flows to them with minimal or no costs of advertising (Podolny, 1993). Furthermore, these producers feel it is *infra dignatatem* to market or to advertise. Slaughter and May has no marketing department, instead depends on its history and word of mouth: "[o]n the whole, the approach of the firm is to present ourselves in an understated way, and to say that we don't believe in big glossy brochures" (Farrell, 1999d: 29). The Big Five accounting firms, however, spend enormous sums on developing global brands (MacKay, 2000: 20).

The interaction between size, reputation and status means markets like capital markets are difficult to enter and price is the least crucial determinant in selecting a professional service firm.[31] The connections between status and quality are, however, at best fuzzy, since they depend upon incomplete signals about their nature from producers, buyers and interested third parties. There are also time lags in the signalling process (White, 1981). The embeddedness of social relations within markets helps to facilitate the distribution of signals, but consumers, for example, large corporations, are usually risk-averse and will require substantial proof of quality standards (Podolny, 1993: 838).

The result of these processes is that a small coterie of investment banks and law firms develops that then consolidates and reproduces itself. Their modes of working and their social positions are recognisable to, and consonant with, each other and result in close proximity in both social and economic spheres of activity. This enables them to establish relationships of trust that reduce the complexity inherent in globalisation to relatively nominal levels: that is, the moral

[30] Skadden Arps, which is now a player in capital markets, established its reputation initially through hostile takeover work (Caplan, 1993).

[31] E.g., the market for auditing services among large corporations is dominated by the Big Five accounting firms which possess the numbers of auditors and cost structure that enable them to undertake, say, the auditing of Ford. See Han (1994).

and epistemic communities produced by their interactions facilitate chaos diminution (Luhmann, 1979). In a world of emerging markets, crisis-ridden economies, the ability to trust, to know who one is dealing with, is essential and it engages the participants in a common cause: to establish a common global patterning for types of work like capital markets (cf. Fukuyama, 1995). To sustain success in capital markets work necessitates continuing modes of excluding outsiders, to preserve the club. With the shared understandings that emerge from a tightly formed relationship it is likely that the normative order constructed around the work becomes encoded in the participants' institutional personae. They, themselves, are the creators and guarantors of the stability of the normative order for capital markets work. The banks and their attendant law firms, in conjunction with international governmental organisations, are embedding their norms in the structures of the countries' legal systems and economies. Because there are only two legal systems at play, English and New York, resistance is virtually impossible, as some far eastern countries have discovered.[32]

Can MDPs become the future vehicles for capital markets work? At present, the Big Five accounting firms are on the periphery of this field. They have been attempting to break into corporate finance, but with minimal effectiveness. If they are successful in attracting large numbers of City, and other, lawyers into their fold, they will be seen to be offering "seamless global service" (Cannon, 1997: 25). Thus far, their main success has been in attracting junior and medium-ranking lawyers.

MDPs appear to be potential vehicles for a whole range of corporate finance work having a global reach far in excess of that of any law firm, provided they can accumulate the expertise from other institutions. However, the transatlantic law firm merger seems to have the potential for expanding law firms' hold over capital markets work. The head of legal and compliance at ING Barings said:

> I'd like to see two major UK firms get into bed with each other then merge with a US firm—Allen & Overy and Freshfields maybe, with Davis Polk or Cravath . . . Then the sparks would really fly. There is a limit to how much UK firms can grow organically and retain respectability; they have to go for quality. For firms of this kind to join with each other would really terrify the rest [Ferguson, 1997: 35].

This is the stark choice facing the big law firms. Their size and the levels of remuneration they can offer are potentially severe obstacles for them, since they cannot match the investment banks and dot coms. The attractiveness of partnership is no longer as strong as it was once was; it is not a secure matching of individual and institution. Either is now able to jettison the other without fuss. Stasis is not an option for law firms, but where they go next to capitalise on their advantages is unclear.

[32] The relaxation of SEC disclosure requirements has now prompted corporates in the Far East to enter the US capital markets.

MDPs have downsides. The questions of standards of quality are relevant—most of the Big Five are agglomerations of franchises, local partnerships, alliances, with overarching global, senior partnerships that dominate. Uniform standards throughout the organisation are difficult, if not impossible, to maintain. Law firms are better able to achieve this, making them more appealing to financial institutions that provide capital markets work which must "take for granted" the quality standards of their advisers. Finally, this raises the problem of how MDPs would overcome the present arrangements of referral based on the critical elements of trust, reputation and status. As diffuse global organisations, they are not structured in ways that enable them to break into the capital markets work. They have not generated sufficient cultural and social capital to become members of a small and exclusive club that creates enormous rewards for its members.

There are problems with limited liability, especially if the Big Five incorporate offshore (for example, in Jersey): accounting firms (and, query, MDPs) cannot travel the Goldman Sachs route and therefore offer the scale of rewards accruing to investment bankers, for example, $10 million this year. And investment banks are already attracting lawyers from private practice. Alliances are not always stable: Arnheim, PwC's original legal head, pointed out, "[b]ig five firms risk giving away their client base if the alliance does not work. In opportunity cost terms, if this arrangement had not worked, PwC would not have burnt its bridges with other law firms" (Cannon, 1997: 27). There are serious conflict of interest difficulties: the *Prince Jefri* case against KPMG demonstrated the courts are reluctant to accept Chinese Walls as long-term solutions to conflicts.[33]

The range of potential conflicts is increasing as regulators take a more proactive role with professional advisors. This is especially marked in the case of the SEC and accounting firms. The SEC has been cracking down on the ownership of shares by managers of accounting firms in their audit clients (*Accountancy Age*, 2000: 1). Further regulatory incursion has occurred with PwC being ordered by the SEC, after it introduced new independence quality controls for auditors, to fire its head of transaction services, a UK partner based in London, because his brother-in-law was the financial controller of audit client, Reuters (Kemeny, 2000: 8). The SEC has considerable extraterritorial clout that could endanger the global ambitions of the mega-professional service firm. And despite opposition from the Big Five and a hostile Congress, the SEC has managed to impose some limits on the range of consultancy work large accountancy firms can undertake for audit clients (Perry, 2000: 4). If these big firms find themselves conflicted out of global business, the cost would be huge. The basic dilemma is as follows: "[i]f a firm audits a company's accounts it has a duty to disclose. If the same firm is a legal adviser to the company it has a duty to protect the client" (Cannon, 1997:

[33] *Prince Jefri Bolkiah* v. *KPMG* (HL) 1998 <http://www.parliament.the-stationery-office.co.uk/pa/ld199899/ldjudgmt/jd.../prince01.htm>.

28). The examples of capital markets work above illuminate the potential for conflict of this type, especially where issues of due diligence are involved.

More subtly, there are the cultural factors that militate against the success of MDPs as capital market vehicles. Any law firm that marries a Big Five accounting firm will be absorbed completely: it can never be a marriage of equals. The Big Five are too big compared to the global law firms. This is one of the reasons we begin to see the transatlantic law firm merger moves beginning. When Clifford Chance originally formed, it was the senior partner's aim to be able to merge with a big accounting firm on equal terms (Flood, 1996). Now that such a merger is no longer feasible, law firms themselves must find alternatives to build economies of scale in the global market.[34] Apart from size, the culture of the organisations is different, with accounting firms arranged more bureaucratically and hierarchically than law firms. Although law firms are, of necessity, becoming corporatised themselves, especially as they grow larger and larger, they have yet to travel as far as accounting firms. Yet there is, perhaps, a movement towards convergence; if so, it is still indeterminate.

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[34] Interestingly, when a large law firm in Sydney, Australia, rejected a merger proposal from a big accounting firm, a quarter of the firm's partners left in protest (*The Lawyer*, 1999c).

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