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## Elite Law Firm Mergers and Reputational Competition

Bruce E. Aronson

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# Elite Law Firm Mergers and Reputational Competition: Is Bigger Really Better? An International Comparison

Bruce E. Aronson\*

## ABSTRACT

*Although rapid law firm growth has persisted since the 1980s, the acceleration of this trend over the last decade by means of mergers is puzzling. Why would normally conservative law firms embark on a merger strategy that appears to encompass significant risk and uncertain benefits? Is this trend a peculiarly U.S. phenomenon?*

*Most of the popular explanations for law firm mergers focus on a single factor: Law firms everywhere cite strikingly similar reasons based on a presumed client demand for "one-stop shopping." This Article contributes to providing a more robust, multi-causal explanation for law firm behavior through a comparative study of reputational competition among elite law firms in selected jurisdictions—the United States, the United Kingdom, Germany, Australia, and Japan. It posits that industry consolidation and changing market conditions have intensified law firm competition and that since firm quality is hard to measure, law firms compete largely on the basis of reputation. Due to their risk-averse nature and the fear of losing existing clients, many law firms are thus paradoxically driven to engage in (defensive) mergers to meet the competition.*

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Through an examination of reputational competition, the Article considers circumstances that are likely to lead to mergers, particularly the elements of reputational signaling, herd behavior, and reputational status as "first-tier" law firms. It identifies "rules of the game" for firm behavior with respect to international mergers. The Article finds that the impact of a strategic decision, such as a merger, by a first-tier firm is of far greater significance than a similar action by another elite firm and is much more likely to lead to defensive actions, such as mergers, by competitor firms. Thus, which firms engage in merger activity in a given market is an important factor in explaining and predicting both the reaction of competitors and whether mergers will become widespread in that market.

This Article further suggests that the common phenomenon of law firm mergers is likely a result of law firms reacting to similar types of changes in their operating environment (i.e., a parallel development), rather than convergence to a U.S. model of the law firm.

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## I. INTRODUCTION

Over the last decade, the legal profession in the United States has gradually become accustomed to the idea that bigger is better for law firms, and a merger is now a common tool to achieve greater scale. In one recent example, within five years two little-known regional law firms merged, added three smaller firms by merger, doubled in size through another merger in October 2004, and in January 2005 completed an international merger with an English firm to create the world's third-largest law firm, with more than 2,700 lawyers at forty-nine offices in eighteen countries.<sup>1</sup>

This recent trend of "serial mergers" highlights a seemingly ever-accelerating race among law firms to grow and achieve a credible size and national (and, increasingly, international) presence or platform. But why would generally conservative law firms embark on a merger strategy which appears to encompass significant risk and uncertain benefits? Is the merger trend truly a result of sophisticated multinational clients demanding "one-stop shopping" for legal services on a global scale, or are there other causes? Which firms among the large or elite corporate law firms are likely to pursue a merger strategy?

These questions are not unique to the United States, as the law firm merger wave has also seemingly engulfed other developed countries. Most of Germany's leading law firms have entered into international mergers or alliances. Even in Japan, which is often perceived as a society where law firms, lawyers, and the law itself are unimportant, all of the top four law firms entered into domestic

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1. The merger, by Piper Rudnick LLP (with main offices in Chicago and Baltimore) and London-based DLA, created a firm that was behind only Clifford Chance and Baker & McKenzie in number of attorneys. With projected annual revenues of \$1.5 billion, it is second only to Clifford Chance. See, e.g., Martha Neil, *A Mondo Merger: Piper Rudnick Teams with London's DLA to Get Really Big, Really Fast*, A.B.A. J. E-REPORT, Dec. 10, 2004. Aggressive expansion continued thereafter, as in mid-2005 the new firm of DLA Piper Rudnick Gray Cary acquired a group of seventy-seven lawyers from Ernst & Young's Russia practice, instantly giving it the largest law office in Moscow. See, e.g., *In Brief*, NAT'L L. J., July 4, 2005, at 3. It next acquired a forty-two attorney group from the disbanded Coudert Brothers to open a Beijing office at the end of 2005. See, e.g., Gina Passarella, *DLA Piper Gets Green Light for Office in Beijing*, THE LEGAL INTELLIGENCER, Dec. 13, 2005, available at <http://www.law.com/jsp/article.jsp?id=1134394508413>. By mid-2006, it was the world's second largest law firm with 3,100 lawyers in twenty-two countries and fifty-nine offices. See, e.g., Lynne Marek, *DLA Piper Aims for Shorter Name and Stronger Brand*, NAT'L L. J., Aug. 18, 2006, available at <http://www.law.com/jsp/article.jsp?id=1155822492779&rss=newswire>.

mergers during the period 2000-2005. And, the first international merger between a significant Japanese firm and a foreign firm (a top English firm, Linklaters) also occurred in 2005. How do these firms' circumstances and motivations compare to those of law firms that undertake mergers in the United States?

The recent wave of mergers among large law firms, both in the United States and in many other countries, presents an interesting puzzle. Neither the prior literature on the growth and development of law firms nor the business strategy explanations provided by the firms themselves fully explain this trend. Supply-side theories, emphasizing how law firms' internal structures can provide a strong impetus for growth,<sup>2</sup> encounter difficulty in explaining mergers, as a merger would presumably tend to destabilize any such internal system. Demand-side explanations emphasize client demand and often include application of the traditional "theory of the firm" to law firm growth with the resulting view that firms will merge if it is more efficient for them to do so.<sup>3</sup> But efficiency is difficult to measure, and it is unclear that law firms are even attempting to measure it.

Law firms themselves justify mergers with demand-side explanations that are surprisingly consistent: Mergers are a response to client needs for greater attorney specialization, large teams of lawyers for significant projects, one-stop shopping, and a greater law firm presence in the relevant market.<sup>4</sup> There is no empirical evidence to back up this presumption of client demand, and one can find large corporations and law firm consultants who claim it is unfounded.<sup>5</sup> By nature, mergers are a risky business, and it is unclear that most mergers are successful. What then seemingly compels law firms to undertake mergers to achieve growth?

In addition, the wave of law firm mergers is by no means uniform. Despite the decade-long trend of law firm mergers in the United States, a number of leading firms have not engaged in mergers and apparently have no intention of doing so. On an international level, nine out of ten law firms in Germany entered into

2. The best-known supply side theory posits a stable promotion-to-partner tournament within law firms. *See infra* note 20 and accompanying text.

3. *See infra* note 26 and accompanying text.

4. *See, e.g.,* Betiayn Tursi, *Firms Should Resist the Urge to Merge*, NAT'L L. J. Feb. 17, 2003, at C3 ("With the trend toward megamerger firms, the current thinking is that existing clients will be in a position to benefit from one-stop shopping"); Leigh Jones, *First the Merger, Then the Brand; Stand-Alone Firms Seek New IDs Also*, NAT'L L. J. May 8, 2006 (referring to law firms' "tired clichés about providing clients with one-stop shopping").

5. *See, e.g., id.* ("Corporate Counsel look at various aspects of a firm in their selection process and it doesn't always mean that they prefer one-stop shopping."); *Spoilt for Choice*, ECONOMIST, July 5, 2001 (stating that "[p]rofessional service firms insist that they want to diversify because their corporate clients demand it. But evidence for such claim is hard to find.").

international mergers or alliances within a year's time around the year 2000, while in other developed countries, such as Australia, no international merger activity occurred.<sup>6</sup> And while most of the leading U.K. firms have embraced a full-service global strategy, the top U.S. firms continue to rely on a national strategy with only selective international expansion.

As law firms themselves have struggled to keep pace in a rapidly changing operating environment over the last decade, scholars face the challenge of providing a more robust theoretical explanation of firm behavior with respect to the recent wave of law firm mergers. To contribute to this effort, this Article focuses on reputational competition, in particular on three reputational elements that deserve greater emphasis or are absent from the literature. The first element is reputational signaling.<sup>7</sup> This Article posits that law firms are reacting to changes in their operating environment (including deregulation, consolidation of clients, and globalization) which have made the market for legal services more fluid and have increased competition among law firms. As competition is based largely on firms' reputations for quality, elite firms have become desperate to signal their quality to clients and other core constituencies.

The second reputational element is herd behavior. Under conditions of uncertainty and incomplete information, firms that are concerned about their reputational standing may be more likely to engage in defensive mergers based on the actions of other firms. Finally, the third element is the role of first-tier law firms.<sup>8</sup> First-tier law firms are a small group of the most profitable firms that have established reputations for expertise in important areas. The concept of first-tier firms is significant both because it has not been explicitly discussed in the academic literature and because it is the reputational element most readily observable in actual firm behavior. In general, first-tier firms, at least in large domestic markets like the United States, do not pursue a strategy of rapid growth and mergers that might place their high profitability at risk. It is the other elite firms or first-tier firms in smaller markets (like the United Kingdom) that are likely to compete through a growth-by-merger strategy.

The international and comparative aspect of law firm growth and mergers has been largely ignored,<sup>9</sup> despite its potential to shed light

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6. See *infra* Part IV.

7. For a discussion of reputational signaling, see *infra* notes 33-38 and accompanying text.

8. For a discussion of the role of first-tier law firms, see *infra* Part II(C).

9. The Author is unaware of any article that attempts to compare law firm growth and its possible causes in several countries. U.S. commentators have written on a number of topics broadly related to law firms and international activities. A partial list would include the following: for globalization of the market for legal services, see, e.g., David M. Trubeck et al., *Global Restructuring and the Law: Studies*

on the causes of law firm behavior in the United States. This Article demonstrates that law firm mergers are not a particularly Anglo-American phenomenon driven by aggressive management of law firms as large businesses, but rather also occur in other developed countries. This raises an additional question from a comparative law perspective of whether, in terms of the recent debate in the area of comparative corporate governance, there is a worldwide movement towards convergence to a U.S. or Anglo-Saxon model of the elite law firm or whether local conditions lead to a path-dependent result preventing any such convergence.

Although these are broad issues, the goals of this Article are modest. First, the Article emphasizes reputational competition through an examination of reputational signaling, herd behavior, and the role of first-tier law firms, and suggests a possible model for law firm reputational signaling. The intention is to extend the existing literature by forming a more generalized and complete view of the role of reputation in the law firm context. As noted above, this is not intended as a complete explanation for law firm mergers, but rather as an aid in providing a multi-causal, robust picture of actual law firm behavior in the merger area. Second, the Article examines the issue of law firm growth by merger from a comparative perspective. Although this study covers only a limited number of countries and issues, it provides both an introduction to common elements or parallel developments among a number of jurisdictions and additional perspectives concerning the factors in the U.S. system that have contributed to the phenomenon of law firm growth by merger.

A third goal of this initial survey is to stimulate further research in this area by highlighting the lack of data and the use of unproven assertions regarding law firm growth and mergers on both a domestic and comparative basis. The increasingly important role of law firms is an area that has not received the attention it deserves in the academic literature. This is not simply a question either of the business success or growing influence of large law firms or, more

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*of the Internationalization of Legal Fields and the Creation of Transnational Arenas*, 44 CASE W. RES. L. REV. 407 (1994); for the expansion of U.S. law firms overseas, see, e.g., Carole Silver, *Globalization and U.S. Market in Legal Services—Shifting Identities*, 31 LAW & POL'Y INT'L BUS. 1093 (2000); for the regulation of foreign lawyers and the possible liberalization of legal services under international trade agreements, see, e.g., SYDNEY M. CONE III, INTERNATIONAL TRADE IN LEGAL SERVICES: REGULATION OF LAWYERS AND FIRMS IN GLOBAL PRACTICE (1996); for overseas examples of multidisciplinary partnerships (as part of the debate as to whether such "MDPs" should be allowed in the United States), see Laurel Terry, *German MDPs: Lessons to Learn*, 84 MINN. L. REV. 1547 (2000); and for ethical considerations in transnational legal practice, see e.g., Richard L. Abel, *The Future of the Legal Profession: Transnational Law Practice*, 44 CASE W. RES. L. REV. 737 (1994) and Mary C. Daly, *The Ethical Implications of the Globalization of the Legal Profession*, 21 FORDHAM INT'L L.J. 1239 (1998).

narrowly, of the fact that many students from elite law schools end up spending much of their professional lives in such firms. Rather, the broader implications of the study of law firms relate to their model for the provision of legal services. The elite U.S. law firm model has had a widespread impact on many other legal service providers, including public interest organizations, government agencies, small boutique law firms, corporate law departments, and as noted in this Article, elite law firms in other countries. Accordingly, what happens to elite law firms—and their model for the provision of legal services—is potentially a matter of great importance and interest.

This Article examines domestic and international mergers in a limited number of jurisdictions, based partly on the differing reactions of law firms in countries where English firms with global strategies wish to gain entry. The Article is divided into six Parts. Part II considers the causes of change and the reaction of law firms to such change in the United States. It also examines the current literature and argues for the necessity of including the elements of reputational signaling, herding, and first-tier firms to provide a robust explanation for the growth of law firms by merger. Part III contrasts the differing approaches of English and U.S. firms to globalization and international markets. Part IV compares law firms in two federal jurisdictions: a country where the leading firms have undertaken international mergers (Germany) with one where they have not (Australia). Part V presents a case study of law firm mergers in Japan. Part VI reconsiders the question of law firm mergers in light of the application of these reputational elements in the case studies. It suggests that the international merger trend is likely a parallel development based on rational responses to similar changes in law firms' operating environments rather than primarily a result of the influence of a U.S. or Anglo-American model.

## II. RECONSIDERING ACADEMIC THEORY RELATING TO LAW FIRM GROWTH BY MERGER

### A. *Market Change and Law Firms' Response: The U.S. Experience*

The United States represents the largest and most developed market for legal services and is an appropriate starting point both for considering reputational elements in law firm mergers and for establishing a basis for comparison with other legal systems. Therefore, it is important to first examine changes in the U.S. market for legal services and the responses of U.S. law firms thereto, which created the conditions conducive to growth by merger. The wave of law firm mergers beginning in the mid-1990s represents the culmination of a series of changes in law firms which began in the



1970s. In general, mergers did not result from law firms voluntarily engaging in a stereotypical transformation from gentlemanly professional organizations to cutthroat businesses in order to increase profits. Rather, firms responded to changes in their operating environments by altering their internal structure, business strategy, compensation, and ultimately, their view of themselves in relation to the new operating environment. These changes provided the setting and, more importantly, the competitive mindset which led to law firm mergers becoming a commonplace phenomenon.

The most fundamental change in law firms' operating environment was the increased competition among law firms. This competition resulted from changes in the business operations of clients and clients' expectations concerning the role of law firms. During the mergers and acquisitions (M&A) boom of the 1980s, many large U.S. corporations expanded the nature and scope of their business activities, while others ceased to exist. This consolidation of industry generally resulted in clients' transactions becoming larger, more time-sensitive, more complex, and increasingly cross-border in nature. At the same time corporate clients expanded and upgraded their in-house counsel and began using different law firms for specific matters, in accordance with the capacities and expertise of each firm, rather than relying on a general relationship with one firm.<sup>10</sup> In addition to law firms competing for work assignments, sometimes in the form of "beauty contests," the new availability of market information on law firms, including statistics on compensation, operated as an additional factor that stimulated law firm competition.<sup>11</sup>

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10. See *infra* note 36 and accompanying text.

11. "Beauty contest" generally refers to the process by which a corporate client establishes a competitive procedure to select outside counsel. They have become larger and more elaborate in recent years. See, e.g., Eriq Gardner, *Pfizer Litigators Endure Beast of a Beauty Contest*, CORP. COUNSEL, Oct. 31, 2005. Changes in the law firms' operating environment and the firms' responses to such changes can be conveniently tracked by the growth and expansion of the legal press. In the early 1980s, the legal press began to provide extensive coverage on what had generally been private matters within firms. See, e.g., Ellen Joan Pollock, *Singing the Latham Song: To Partners and Association, Latham and Watkins is Not Just a Law Firm, It's a Place of Worship. Will All the Good Feelings—and High Profits—Surviving When Clinton Stevenson Steps Down?*, AM. LAW., Oct. 1986, at 125; Claudia Weinstein, *Heavy Hitter: Calling the Plays at Baker and Daniels*, AM. LAW., Apr. 1987, at 21. The most significant event was probably the initial publication of the "AmLaw 100" in 1985 (which began in that year as the "AmLaw 50"), with its change of focus from "large" law firms, measured by the number of attorneys, to "large businesses" measured by revenue and profits. See Steven Brill, *The AmLaw 50: America's Fifty Highest-Grossing Firms*, AM. LAW., July/Aug. 1985, at 1. The subsequent tracking of new phenomena by the legal press (such as law firm merger data tracked by law firm consultants Hildebrandt International beginning in the mid-1990s and the annual lateral report begun by *The American Lawyer* in 2001), reflected new trends. See Hildebrandt.com, *Mergers and Acquisitions*, [http://www.hildebrandt.com/Consulting\\_Services.aspx?BD\\_ID=4852](http://www.hildebrandt.com/Consulting_Services.aspx?BD_ID=4852) (last

Many law firms responded in a dramatic fashion to these changes in clients' businesses and expectations, as well as to the new competition to provide legal services. Firms grew rapidly in size, opened new offices both domestically and overseas, developed new areas of expertise to complement their existing practices, and in many cases merged with other law firms.<sup>12</sup> There was a new emphasis on productivity and profitability, including a fundamental change among many U.S. firms in the compensation of partners from a lockstep compensation system based strictly on seniority to a performance-based system.<sup>13</sup> Partners who did not meet productivity

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visited Apr. 23, 2007) (describing Hildebrandt's consulting service which tracks law firm mergers and acquisitions). The legal press rankings also provided new metrics (such as profitability rather than size) and highlighted firms that were rapidly and aggressively adapting to new market conditions (generally portraying them in a positive light). This also extended to a direct ranking of reputation based on perceptions of currently practicing attorneys. See, e.g., Vault.com, Rankings Methodology, [http://www.vault.com/nr/lawrankings.jsp?law2006=7&ch\\_id=242](http://www.vault.com/nr/lawrankings.jsp?law2006=7&ch_id=242) (commenting that "Vault does not assess[ ] firms by profit, size, lifestyle, number of deals or quality of service; [it] rank[s] the most prestigious law firms based on the perceptions of currently practicing lawyers at peer firms").

12. While a firm of 200 attorneys was considered a "big" New York firm in the 1980s, in 2005 a law firm needed 400 lawyers for inclusion in a list of the 100 largest U.S. law firms. See The NLJ 250, NAT'L L.J., Nov. 14, 2005, at S22. The total number of lawyers in AmLaw 100 firms has nearly tripled between the first survey in 1986 and a recent survey in 2005 (i.e., 25,994 in 1986 versus 70,161 in 2005). See Alison Frankel, *The AmLaw 100 2006: Growing Pains*, AM. LAW., May 2006, at 94, available at <http://www.law.com/jsp/tal/PubArticleTAL.jsp?hubtype=Cover+Story&id=1145964622373>. Firms in the 150-400 lawyer range are now routinely referred to as "mid-size" firms. See, e.g., Vivia Chen, *Success on a Smaller Scale: Focus, Creativity, and Reinvention Help Second Hundred Firms Survive—and Thrive—in the Shadow of the AM LAW 100*, AM. LAW. Aug. 2005 (noting that the total head count at the second hundred firms below the Am Law 100 was 25,940 in 2003, or an average of 259 lawyers per firm).

13. This merit-based pay system is sometimes referred to by the inelegant expression that you "eat what you kill." See, e.g., Leigh Jones, *Plunging Into a Global Practice; Overseas Mergers Are No Easy Task*, NAT'L L. J., Oct. 11, 2004 (noting that a seniority-based partner compensation system contrasts "with the so-called eat-what-you-kill approach, a form of merit pay in which attorney compensation correlates with how much business they bring in"). Under the traditional lockstep system, younger partners were generally underpaid for their efforts, while older partners tended to be overcompensated relative to their contribution to the firm. This system worked in a well-capitalized firm in a stable setting where young partners were confident that the system would still be in place and work to their benefit when they became senior partners. However, as firms grew and it became common for partners to move among firms, it became increasingly difficult to pay partners on any basis other than current performance. Young partners will generally not agree to delay receiving compensation and invest in a firm's future when other firms will pay them more in accordance with their current market value. However, a number of highly profitable first-tier firms were able to maintain a lockstep system with its greater stability. See *infra* note 41; see generally MARC S. GALANTER & THOMAS M. PALAY, *TOURNAMENT OF LAWYERS: THE TRANSFORMATION OF THE BIG LAW FIRM* (1991); Marc S. Galanter & Thomas M. Palay, *Why the Big Get Bigger: The Promotion-to-Partner Tournament and the Growth of Large Law Firms*, 76 VA. L. REV. 727 (1990).

standards could essentially be fired, while successful partners could easily move their portable business to another firm. Increased mobility is both a cause and an effect of other changes in the market for legal services and law firm structures. This new role of lawyers as free agents adds to the pressure for each firm to perform on par with its peers.

The rapid growth of law firms into large, complex businesses also meant that they outgrew their traditional cultures, staffing and promotion systems, and methods of governance. There has been a large growth in non-equity partners, such that some have proclaimed the end of the law firm "pyramid structure," with its replacement being dubbed the "diamond" structure.<sup>14</sup> As law firms have grown larger, the traditional partnership form of management has grown increasingly unwieldy. Firms have gradually evolved into a more corporate structure, and on a daily basis individual partners are not involved with, and are often not aware of, detailed matters concerning firm management.<sup>15</sup>

In response to the perceived need to remain competitive in terms of size or credible mass, since the late 1990s there has been a wave of domestic mergers between large firms, despite the considerable risks

14. See Joel F. Henning, *The New Reality in the Legal Profession*, 70 TEMP. L. REV. 1247, 1251 (1997). Non-equity partners are attorneys who are treated as partners in terms of outward appearance (i.e., in relations with clients and other outside parties) but do not share in a percentage of the firm's profits and are therefore not owners of the firm. A majority of large law firms now have non-equity partners, and their numbers are increasing. For example, during the period from 2000 to 2005, non-equity partners at AmLaw 100 firms grew by 88% while equity partners grew by only 17%. (Overall attorney headcount increased by 26%.) See *The AmLaw 100 2006: The Century thus far*, AM. LAW., May 2006, at 125. Some law firms have been accused of rapidly increasing their non-equity partners to unfairly boost their profit per equity partner and their ranking in the AmLaw 100 and other annual law firm surveys. See, e.g., Lauren Gard, *Pillsbury Revamps Partnership, Talks Merger*, N.Y. L.J., Mar. 16, 2000. This is analogous to corporations managing their reported earnings, with the result that equity analysts of corporations began to emphasize cash flow or free cash flow, which is considered more difficult to manipulate. The law firm equivalent has been a similar movement toward an emphasis on "revenue per lawyer" (or "revenue per legal professional") as a replacement for the traditional profitability metric of income per partner. See Lisa Isom-Rodriguez, INST. OF MGMT. & ADMIN., ARE PARTNER ADMISSIONS EATING YOUR FIRM PROFITS? (2001).

15. This is similar to the path previously followed by other large professional service organizations, such as accounting firms, and includes, in many cases, a change to a limited liability partnership when that corporate form became available in the mid-1990s. Day-to-day management has also come to resemble more of a corporate form with a managing partner (similar to the president of a corporation) and a management committee (like a board of directors). The "corporatization" of firm management has reached the point where there may now be a serious issue as to whether a partner may be characterized as an employee, rather than an employer, for purposes of an EEOC investigation of age discrimination. See *EEOC v. Sidley Austin Brown & Wood LLP*, 406 F. Supp. 2d 991 (N.D. Ill. 2005) (claiming damages on behalf of thirty-one former partners who were either fired or demoted during a law firm restructuring).

involved.<sup>16</sup> Significantly, in recent years many of these mergers have resulted from strategic behavior. That is, rather than having specific knowledge of a firm that would be a good fit, a law firm may decide it wants a merger partner with certain characteristics (i.e., a New York presence) and, aided by one of the increasingly important law firm consultants, will go down the list of firm rankings and identify possibilities. It is not unusual that the first serious merger discussions are not ultimately fruitful and the firm proceeds to the next candidate(s) on its list before achieving a successful merger.<sup>17</sup>

### B. Academic Theory and the Puzzle of Law Firm Mergers

Law firm mergers provide perhaps the best illustration of some of the problems encountered by the academic literature in explaining law firm growth. Various theories have emphasized some aspect of economic analysis to explain the phenomenon of law firm growth and the evolution of organizational structure. Although somewhat of an oversimplification, these theories can be divided into two main approaches to identifying and analyzing law firms' economic incentives for growth: supply-side theories, which emphasize law firms' internal structure as a response to the mutual monitoring problem, and demand-side theories, which focus on the demand for legal services and firm efficiency.<sup>18</sup>

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16. There is no universally accepted data on law firm mergers. The most widely cited data is from Hildebrandt International, which attempts to track all mergers involving firms with more than five attorneys. Their reported numbers range from a high of seventy-five for the year 2000 to forty-seven in 2004. Although the number of mergers has fallen since 2000, on average they involve larger firms. See generally Hildebrandt International Press Room: MergerWatch, [http://www.hildebrandt.com/Documents.aspx?WP\\_ID=422](http://www.hildebrandt.com/Documents.aspx?WP_ID=422) (last visited Apr. 23, 2007). The perception of a wave of mergers beginning in the mid-to-late 1990s may also be influenced by poor law firm performance and a decline in merger activity in the early 1990s. See, e.g., Thom Weidlich, *Law Firm Mergers Dwindle, but Acquiring Practice Groups Remains Popular*, NAT'L L. J., Apr. 19, 1993 (noting that "the wave of law firm mergers in the 1980s has dwindled to a drip . . .").

17. See, e.g., Brenda Sapino Jeffreys, *Locke Liddell Merger with Lord Bissel Will Form 700-Lawyer Firm*, TEX. LAW., May 25, 2007 (quoting the managing partner of Locke Liddell as stating that the firm, having been searching for a merger partner for several years, found "one that finally made sense").

18. Some commentators have pointed to other trends not directly related to either supply or demand, which are not discussed in this Article. Most prominent among them is the view that technology would have a decisive influence on the form and method of providing legal services. See, e.g., R. SUSSKIND, *THE FUTURE OF LAW: FACING THE CHALLENGES OF INFORMATION TECHNOLOGY* 270-71 (1996) (predicting that in the cyberspace era, lawyers would need to change from reactive work based on client requests for legal advice to proactive "legal information engineers," providing information to a broader audience with a different method of compensation than current advisory services). For an update as to this prediction, see R. SUSSKIND, *TRANSFORMING THE LAW* (2000).

On the supply side, Gilson and Mnookin's seminal work emphasized law firm growth as a method of leveraging and effectively using surplus human capital accumulated by the partners into a portfolio of capital within the firm.<sup>19</sup> Galanter and Palay provided the most prevalent view of the growth of law firms, positing that growth resulted from internal pressure generated by a promotion-to-partner tournament as the means by which associates would work hard despite serious monitoring costs and information asymmetries.<sup>20</sup> Subsequently, Wilkins and Gulati reconceived the tournament in response to changing law firm practices,<sup>21</sup> while in a contrary labor production thesis, Kordana asserted that there really was no monitoring problem, as senior attorneys can easily track associates hours, and that the growth of law firms resulted from the use of associates as labor production factors.<sup>22</sup>

Despite the valuable contributions provided by these works, in particular Gilson and Mnookin's fundamental insight concerning firm-specific capital and the "renting" of firm reputation and Wilkins

However, there is anecdotal evidence that, much like associate salaries, most firms seek only to keep up with the prevalent big-firm standards in technology, rather than seeking to use it as a competitive advantage. See, e.g., M. Voorhees, *Faraway Pay Day: When will Firms' Investment in Technology Produce Dividends?*, AM. LAW., Mar. 7, 2000 (noting that although large law firms invest in technology, such investment is not linked to profitability).

19. See generally Ronald J. Gilson & Robert H. Mnookin, *Sharing Among the Capitalists: An Economic Inquiry into the Corporate Law Firm and How Partners Split Profits*, 37 STAN. L. REV. 313 (1985) (stating that law firms are structured so as to maximize gains from diversification and minimize agency costs).

20. See generally GALANTER & PALAY, *supra* note 13; Galanter & Palay, *supra* note 13. According to this view, the governing mechanisms adopted by law firms to monitor performance also require growth at an exponential rate. Firms must promote a steady percentage of associates to partner to incentivize associates to work diligently in the absence of monitoring, thereby creating constant internal pressure for growth so that they can maintain enough partner position prizes for the tournament.

21. See, e.g., David B. Wilkins & G. Mitu Gulati, *Reconceiving the Tournament of Lawyers: Tracking, Seeding, and Information Control in the Internal Labor Markets of Elite Law Firms*, 84 VA. L. REV. 1581 (1998) (utilizing signaling theory and relational capital to characterize firms as adapting a multiple incentive system which includes as one factor a "multi-round" tournament more akin to actual sporting events—including "tracking," "seeding," and "information control"—than tournaments under standard economic theory; in other words, it describes a limited competition among senior associates to make partner as one factor, although not necessarily the main cause, contributing to law firm growth); see also Scott Baker et al., *The Rat Race as an Information-Forcing Device*, 81 IND. L.J. 53, 57-58 (2006) (characterizing the first round of a tournament as a "revelation tournament" in which objective factors like billable hours are used to force information about more important subjective factors, such as good judgment, to choose candidates for the next round of the tournament).

22. See Kevin A. Kordana, Note, *Law Firms and Associate Careers: Tournament Theory Versus the Production-Imperative Model*, 104 YALE L. J. 1907, 1908 (1995) (suggesting that "the type of work performed in law firms dictates their structure, that law firms hire associates to keep their costs down and profits up, and that associates come to large firms mainly to improve their lawyering skills and increase their human capital").

and Gulati's use of signaling theory, all of these supply-side theories are subject to similar limitations. They tend to focus primarily on the institutional structures of law firms and largely ignore other factors, such as the demand for legal services.<sup>23</sup> A tournament theory, in particular, encounters difficulty in explaining the increasingly long and tenuous partnership track<sup>24</sup> and the active lateral market for attorneys, let alone the recent wave of law firm mergers. There would presumably be no better way to destabilize the expectations (or the rules) implicit in a tournament than to suddenly add a large number of new partners and associates to the mix. It is also possible that the supply-side views are, in part, asking the wrong question by focusing exclusively on an economic explanation as to why associates work hard in the absence of meaningful firm monitoring.<sup>25</sup>

On the demand side, some commentators have written of the potential effect of multidisciplinary practices, in particular the competitive role of the big accounting firms, with their greater capability of providing one-stop shopping.<sup>26</sup> Thomas proposed a

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23. This was the main theme in a number of book reviews of Galanter and Palay's book. See, e.g., Robert L. Nelson, *Of Tournaments and Transformations: Explaining the Growth of Large Law Firms*, 1992 WIS. L. REV. 733,747-49 (reviewing GALANTER & PALAY, *supra* note 13). This was not true of Gilson and Mnookin's original work on human capital which dealt extensively with law firm-client relationships, how such relationships might change with the rising importance of in-house counsel, and the effect of such change on the internal structure of law firms. See Gilson & Mnookin, *supra* note 19. Although one could object to the classification of Gilson and Mnookin's work as supply side theory for this reason, their focus on internal firm structure clearly inspired subsequent supply side efforts like those of Galanter and Palay.

24. The partner track at most elite law firms has become a long, arduous three-tier process (i.e., associate to non-equity partner to equity partner). In addition, the percentage of associates making partner has declined. Recent surveys indicate that the rate of promotion to partner at elite firms in 2004 was 2.5%. See Leigh Jones, *Toughest Case is Making Partner*, NAT'L L.J., Aug. 31, 2005, available at <http://www.law.com/jsp/article.jsp?id=1125392710244> (citing studies by Citigroup Private Bank). This contrasts with the higher, stable promotion rates found from the 1950s through 1980s by Galanter and Palay. See GALANTER & PALAY, *supra* note 13, at 104 (finding that the average promotion rates ranged from 5.34-5.85 for Group I firms and 5.55-8.19 for Group II firms).

25. It should be noted that, although academics have undertaken great efforts to give elaborate economic explanations as to why lawyers work hard in the absence of effective monitoring, it may be that this is a result of a socialization process involving professional values and attitudes that cannot be explained effectively by economic analysis. Other commentators have previously raised this possibility. See, e.g., Gilson and Mnookin, *supra* note 19, at 775-80.

26. See Randall S. Thomas et. al., *Megafirms*, 80 N.C. L. REV. 115, 171-79 (2001). Despite claims that clients are demanding multidisciplinary service from professional firms, the evidence is not clear. Indeed, some fault multidisciplinary practices for merely tacking on new services to an existing structure rather than meeting the needs of business clients by assuming the more challenging role of integrating professional services as a "general contractor." See, e.g., *Spoilt for Choice*, *supra* note 5 (citing former Harvard Business School professor David Maister and also

demand-side view that law firms were simply consolidating as had accounting firms before them, as industry consolidation and globalization produced a smaller number of “megaprojects” which made it more efficient to create “megafirms” in all professional service industries.<sup>27</sup> This is an attractive theoretical argument; however, a lack of empirical evidence raises important questions concerning its factual premises: Are clients actually demanding multinational one-stop shopping from legal service providers? And do law firms actually consider theory of the firm efficiencies when entering into mergers?

Accordingly, the basic puzzle remains: Why would generally conservative law firms undertake risky mergers? This puzzle necessarily involves two underlying assumptions which are difficult to demonstrate empirically: (1) lawyers and law firm managers are conservative or risk-averse,<sup>28</sup> and (2) there is a substantial risk that

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stating that “[p]rofessional-service firms insist that they want to diversify because their corporate clients demand it. But the evidence for such a claim is hard to find.”). The significance of legal practices operated by accounting firms has significantly declined following the breakup of Anderson Legal, which had been the most aggressive accounting firm-related law practice, as well as a new post-Sarbanes-Oxley emphasis on potential conflicts of interest in consulting and other services formerly offered by all the major accounting firms. See *International Law Firms: Trying to Get the Right Balance*, *infra* note 27; Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, 116 Stat. 745, Title II, §§ 201, 202 (amending § 10A of the Securities and Exchange Act of 1934 (15 U.S.C.A. § 78j-1) (prohibiting auditing firms from providing a number of non-audit services to public companies and requiring pre-approval by the company’s audit committee for any permitted non-audit services).

27. See Randall S. Thomas et. al., *supra* note 26, at 136-153. A detailed examination of the complex question of comparing the law and accounting fields is beyond the scope of this Article. However, law is local, and there is no compelling need, as in accounting, to utilize similar principles and treatment throughout the national and international operations of a single business organization. For an argument that law firms differ from accounting or advertising firms, and it is unlikely that a small group of law firms will ever dominate the legal services industry on a global scale, see *International Law Firms: Trying to Get the Right Balance*, *ECONOMIST*, Feb. 28, 2004, at 65.

28. Although trying to prove that lawyers are generally risk-averse might be futile in any case, there are a number of persuasive arguments. First, individuals who join the legal profession, as opposed to becoming businessmen, tend to be hardworking but risk-averse individuals. They have been successful at gathering prestigious credentials but often lack clear career goals (i.e., business plans). Second, a significant part of a lawyer’s work involves identifying risks and helping a client avoid or minimize such risks in business operations, often through reliance on existing precedent. It would be unsurprising that this attitude would carry over to the firm’s own business operations. Many commentators note that, despite becoming substantial organizations, law firms are frequently not managed like businesses. For an overview, see, e.g., Allen M. Terrell, Jr., *Managing the Big Firm*, 19 *DEL. LAW.* 24 (Spring 2001). Third, although management of elite law firms has rapidly been gaining executive authority and is no longer characterized by detailed discussions at the partnership level to achieve a consensus, both traditional values of autonomy and the increased mobility of many lawyers with portable practices mean that management may still be relatively constrained from embarking on new risk-taking endeavors without first establishing substantial firm-wide support. Fourth, from the perspective of

law firm mergers will not be successful in creating value for shareholders (i.e., partners). Although a detailed analysis of the former is beyond the scope of this Article, a number of arguments support the proposition that lawyers are generally risk-averse.

With respect to the risk inherent in mergers, there is almost no research available on the relatively recent phenomenon of law firm mergers.<sup>29</sup> There are no obvious economies of scale or scope for law firms in a merger, where productivity is largely a result of billings by individual professionals, and such mergers can also be highly disruptive.<sup>30</sup> The substantial literature on corporate mergers may

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organizational behavior, even among more directly comparable professional service organizations, law firms are often characterized as being more conservative than other such organizations. *See, e.g.,* David Maister, *The Trouble With Lawyers: The Qualities That Propel Lawyers to Success Can Also Make Forging a Cohesive Law Firm Nearly Impossible. Can People Who are Trained to be Skeptical and Detached Put the Mistrust Aside When Dealing With Their Own Partners?*, AM. LAW., Apr. 2006, at 97 (arguing that lawyers' managerial approach based on autonomy and individualism is less effective than the team approach of other professional service firms in servicing large corporate clients).

29. The few studies that are available rely on limited samples and are produced by law firm consultants that promote mergers. *See, e.g.,* Ward Bower & Debra L. Rhodunda, *Are Large Law Firm Mergers Successful?* 30 REP. TO LEGAL MGMT. 6 (Altman Weil, Inc. Sept. 2003) (examining seventeen mergers among large law firms and concluding that they were successful in both the short term, since profits per partner increased in the first two years compared to the profit level of the larger pre-merger firm, and that the seven mergers that occurred more than four years ago were also successful in the long term, as the rate of increase in profits per partner was higher than for the AmLaw 100 as a whole during the same period). However, a simple change in average profits per partner is of less use than measuring return on investment for corporate mergers, since it is difficult to separate merger performance from unrelated factors. *See, e.g.,* Lisa R. Smith, *Mergers—How Do You Measure Success?*, Nov. 9, 1999, [http://www.hildebrandt.com/Documents.aspx?Doc\\_ID=616](http://www.hildebrandt.com/Documents.aspx?Doc_ID=616). There is also no data on the rate at which proposed law firm mergers are consummated, despite the fact that it is not unusual for merger attempts to be unsuccessful due to the real obstacles of client conflicts and differing compensation systems between potential merger partners.

30. There could be productivity gains from mergers if the merging firms used the merger as an opportunity to expel or de-equitize non-productive partners, and there is anecdotal evidence that this occurs. *See, e.g.,* Carolyn Kolker, *Take Down*, AM. LAW. Feb. 2003, at 68 (describing how underperforming partners were eliminated at New York's Winthrop, Stimson, Putnam & Roberts following its January 1, 2001 merger with San Francisco's Pillsbury, Madison & Sutro). However, mergers or attempted mergers can also be highly disruptive and lead to unforeseen consequences. They may lead to unplanned departures, not only from attorneys who want to "stick to their knitting" and fear the practice style and pressures of a much larger firm but also conversely from attorneys who think their firms did not reach high enough in establishing a firm's national platform. *See, e.g.,* Elisabeth Preis, *Postmerger Flight at KMZ*, AM. LAW., July 2002. And like corporate mergers, proposed law firm mergers can now have the effect of "putting firms into play," with various consequences including cherry picking of attorneys, practice groups, or offices and, in the worst case scenario, dissolution of the firm. A recent example of this phenomenon was the failed merger of Orrick Harrington and Sutcliffe and Coudert Brothers, with the resulting cherry picking of lawyers by Orrick and dissolution of Coudert Brothers. *See, e.g.,*



provide some basis for comparison. That literature generally finds that such mergers are not in the interests of shareholders, but rather typically result from empire-building by CEOs.<sup>31</sup> One parallel between the legal and corporate world is that there are very few true mergers of equals (although many law firms attempt to characterize their mergers as such), with the result that one of the firms is ultimately surrendering its autonomy and control of firm policies and partner compensation for the sake of being part of a larger organization.

### C. Developing a More Robust Explanation

In an effort to provide a multi-causal, more robust explanation of the puzzle of law firm mergers and firm behavior, this Article examines reputational competition by incorporating three significant reputational elements into the story: (i) reputational signaling, (ii) herd behavior, and (iii) the role of first-tier law firms. Law firms' responses to changing market conditions has led to economic success for many firms but comes at the cost of increased institutional instability,<sup>32</sup> as even long-standing firms can be "put into play" or breakup on short notice. Given the higher stakes, high monitoring costs, and the difficulty of judging the quality of law firm work, elite firms have become desperate to signal<sup>33</sup> their credibility and

Anthony Lin, *Coudert Breakup Voted After Merger Talks Fail*, NAT'L L. J., Aug. 19, 2005.

31. See, e.g., Gretchen Morgenson, *What Are Mergers Good For?*, N.Y. TIMES, June 5, 2005 (noting that "[a]cademic research suggests that few mergers add up to significantly more prosperous or successful companies..." and that the chief beneficiaries may be business executives and investment bankers); Dennis K. Berman and Almar Latour, *H-P Reboots; Too Big: Learning from Mistakes—Florina's Departure from H-P Reminds Companies About Risks During the Current Merger Boom*, WALL ST. J., Feb. 10, 2005 (citing the research of Sam Rovit, of Bain & Co., that only 28% of deals result in a substantial increase in shareholder value); David Harding and Sam Rovit, *Building Deals on Bedrock*, HARV. BUS. REV., Sept. 1, 2004 (concluding that mergers are useful only in two limited circumstances).

32. This was noted as early as 1985 by Gilson and Mnookin, at a time when many large firms were in the process of transitioning from lockstep compensation systems to performance-based compensation, which made it more difficult to create firm-specific capital and was likely to decrease the stability of large firms. See Gilson & Mnookin, *supra* note 19, at 387. This observation is even more accurate today.

33. Signaling theory was used extensively by Wilkins and Gulati. See Wilkins & Gulati, *supra* note 21. They focused primarily on the internal labor markets of law firms but also noted law firm signaling to clients and law students. *Id.* at 1654-55. Gilson and Mnookin distinguished between law firms providing direct information to clients on firm quality by means such as a Practicing Law Institute seminar (which they call "searching"), and providing indirect information on quality ("signaling"). See Gilson & Mnookin, *supra* note 19, at 362-65. Use of the term "reputational signaling" in a similar vein should be distinguished from another use of the term by Eric Posner, who uses that term to represent an answer to the collective action problem. See generally ERIC A. POSNER, LAW AND SOCIAL NORMS (2000) (theorizing that even in the

reputation to three core constituencies: clients and potential clients, other law firms (potential laterals),<sup>34</sup> and law students (potential associates).<sup>35</sup>

It should be emphasized that these constituencies do not exist in isolation. There is a considerable spillover and multiplier effect since the most effective way to send reputational signals is, in fact, to emphasize successes with one of these constituencies—obtaining a prestigious new client, new laterals, or new associates from prestigious law schools. This raises the stakes considerably since success in appealing to one constituency often breeds success with others, while failure with one constituency can quickly become a vicious circle. Market information on law firms is also important as firms create their own signals and react to market information. The relationships among constituencies and reputational signaling are illustrated in Diagram 1.

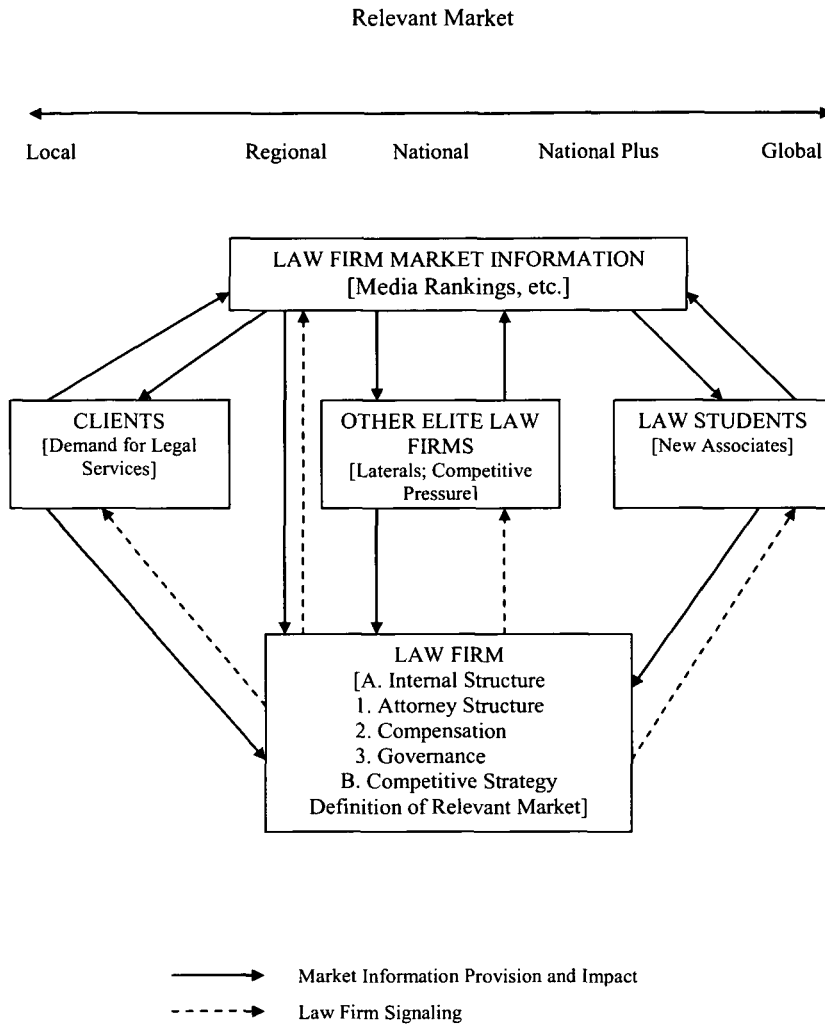
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absence of regulatory incentives, individuals will contribute to collective goods, even when it is not in their immediate economic interest to do so, in order to build up a reputation that will encourage others to deal with them in the future).

34. This constituency represents both a source of supply, in the form of associates and service partners, and demand, in the form of partners with portable business. Firms that are perceived to be successful can add additional attorneys and even new practice areas with relative ease, while firms under pressure will have difficulty in retaining their own attorneys. The ability to attract laterals also becomes a signal of the firm's quality.

35. Firms must also signal law students about the firms' qualities and prospects in order to attract high quality associates. As law students have the least information of any of a law firm's constituencies, signaling assumes particular importance. This is accomplished by means of competing with respect to associate compensation, summer associate and permanent associate recruitment programs, firm rankings, and signaling about firm reputation in general.

Diagram 1  
Model of Reputational Signaling by Elite Law Firms



The continuing importance of reputational signaling may seem surprising. One might have predicted under economic theory that market changes in the 1980s, which led to large corporations upgrading their in-house capabilities and increased competition among elite law firms, would produce a number of results: (i) less work for law firms as additional in-house capacity resulted in more work being brought in-house; (ii) greater price competition among law firms (and lower billing rates and profits); and (iii) increased use of direct selling of law firm quality to sophisticated in-house counsel, as

opposed to indirect market signaling of firm quality through efforts to enhance firm reputation and marketing.<sup>36</sup>

In fact, none of the above occurred. Greater client power has led to increased competition among elite law firms but primarily in the areas that corporate clients care about the most: quality and responsiveness (which make a law firm a safe choice for “bet the firm” deals, which are not price sensitive) and anything that might tend to indicate these qualities. Cost is a major concern for more commodity-type work, which elite firms wish to minimize. However, in any event, law firm billing rates have continued to rise at rates above inflation.<sup>37</sup> Reputational signaling has increased and remains the most important element of law firm marketing activity, despite some increase in direct sales activities to corporate clients.<sup>38</sup>

The importance of signaling is reinforced by herd behavior.<sup>39</sup> If it is difficult for clients to judge law firm quality, it also appears to be difficult for law firms to be confident of what clients truly want. Under such circumstances of uncertainty and incomplete information, it is unsurprising that there is a tendency for law firms to follow the decisions of other firms. This is particularly true for mergers, which result in dramatic attention-grabbing headlines and the promise of a new start on a larger platform. Herd behavior certainly has the potential to result in inefficiencies, but it is rational to follow the prevailing conventional wisdom and avoid being left behind if law

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36. For a prediction of the looming dominance of in-house counsel over outside law firms, see, e.g., A. Chayes & A. Chayes, *Corporate Counsel and the Elite Law Firm*, 37 STAN. L. REV. 277 (1985). Gilson and Mnookin also predicted that more sophisticated in-house counsel would cause both an increase in the use of direct selling and a decrease in reliance on general reputation. See Gilson & Mnookin, *supra* note 19, at 384. In their terms, more sophisticated in-house counsel would reduce the value of firm-specific capital (which they state is due to “some significant extent” to “high information costs and unsophisticated purchasers”). *Id.*

37. Billing rates have increased faster than inflation as measured by the Consumer Price Index. Inflation alone would have caused a 70% increase during the period from 1984-2003, while the actual rates reportedly rose by 114% for senior partners and 130% for senior associates, with the gap between inflation and billing rates widening after 1995. See Gary Young, *In Focus: Billing*, NAT'L L.J., Dec. 1, 2003 (citing annual surveys by Altman Weil Inc.).

38. Direct sales activities include a much larger role for competitive beauty contests and a modest increase in more general advertising and marketing activities. Although there are many anecdotes about elite law firms now resorting to marketing and advertising practices they did not utilize in the past, in reality they spend little effort on marketing compared to corporations. See, e.g., Larry Bodine, *How Much Money Should I Spend?*, L. PRAC., Mar. 2005, at 35 (noting that while most corporations spend 10-15% of revenues on marketing, according to the 2004 Altman Weil Survey of Law Firm Economics, large law firms spend an average of 1.5% on advertising).

39. See, e.g., Timur Kuran & Cass R. Sunstein, *Availability Cascades and Risk Regulation*, 51 STAN. L. REV. 683 (1999). For a short, non-academic discussion of herd behavior on a current topic, see e.g., Robert H. Frank, *The Herd Changes Course and Runs Away From S.U.V.s*, N.Y. TIMES, Aug. 3, 2006, at 3.

firms are being judged primarily, or even significantly, based on their reputation. As in other fields, such as mutual fund managers, following the crowd may also result in a less negative reaction if the resulting performance is poor.

In the case of law firm mergers, the perceived conventional wisdom is that a major law firm with significant clients now needs a national (or, increasingly, international) platform and credible mass (with the law firm size required to achieve this nebulous goal increasing very rapidly over the last decade). Given uncertainty and incomplete information, it may well appear to law firms that it is risky to stand pat and face the possibility of losing existing clients to more aggressive competitors who capture headlines through substantial mergers. If so, herd behavior would constitute a significant element in explaining the seeming paradox of conservative law firms engaging in risky mergers.

A third element that may be necessary to explain law firm growth and mergers is the importance of first-tier law firms. To date, legal commentators have loosely and interchangeably used terms such as "large" or "elite" law firms; the use of more narrow terms such as "first-tier" firms has been largely the province of law firm consultants and the legal press. Although exact definitions are both difficult and unnecessary for this analysis, it is important to have at least broad functional definitions, given the significant impact that a law firm's reputation has on its growth and business strategies and on its competitors. It is the reputational element that is most readily observable in firm behavior, and it is possible to construct rules of the game for law firm mergers based on this concept.

The leading or first-tier law firms are a small group within the elite firms<sup>40</sup> that have established reputations for expertise in important areas (such as M&A, capital markets, and significant commercial litigation) and are known for high value-added services that are price-insensitive. In the United States, they correspond closely to the most profitable firms rather than to the largest firms. These firms' high profitability and strong reputations have allowed them to maintain stability and institutional values while most elite law firms have undergone significant transformations in response to increased competition over the last two decades. Elite and first-tier firms operate in all of the jurisdictions surveyed in this Article, as shown in Table 1.

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40. As a functional definition, elite law firms may be characterized as the firms that provide general legal services to large corporations (i.e., not "boutique" firms) and use specialized skills to handle large complex matters on a national scale for these clients. In most countries, such as the United States, elite firms correspond fairly closely with large corporate law firms, and the AmLaw 100 would likely be an acceptable proxy for elite law firms in the United States.

**TABLE 1**  
**ELITE LAW FIRMS IN SELECTED COUNTRIES**

	Total No. of Lawyers	No. of Elite Firms	Percentage of Elite Firm	No. of First Tier Firms
			Lawyers/Total No. of Lawyers	
United States	1,084,504	100	6.3%	7-10
United Kingdom	141,641	20-25	7.3%	5
Germany	116,305	15	2.9%	6
Australia	32,300	12-15	25.9%	6
Japan	21,174	9	5.6%	4

Note: This table is only intended to provide a rough comparison among the jurisdictions included in this Article. Results would vary based on a number of factors, including the following: (1) the basis for deciding the number of elite firms in each jurisdiction, (2) the definition of "lawyer" as opposed to other legal professionals who may fulfill similar functions outside the United States (for an illustration of this issue with respect to Japan, *see infra* note 123), and (3) a focus on the total number of lawyers as opposed to practicing attorneys.

Sources: See sources listed *infra* in the country specific tables.

The theoretical underpinning for introducing this concept into the academic literature was provided by Gilson and Mnookin in their discussion of the difficulty encountered by firms in creating firm-specific capital and the stability of firms who were successful in doing so.<sup>41</sup> In the real world there is potentially a huge payoff for a law

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41. Gilson and Mnookin characterize firm-specific capital as the glue that holds firms together, i.e., the client relationships and firm reputation that make it more attractive for attorneys to stay in the firm rather than move elsewhere. *See* Gilson & Mnookin, *supra* note 19, at 355. They question what was at the time the "new conventional wisdom" that preferred partner compensation based on productivity rather than the traditional, seniority-based lockstep system, on the basis that the lockstep system helped to maintain firm stability. *Id.* at 346-55. They also anticipated that, with the rise of sophisticated in-house counsel, it would become more difficult to create firm-specific capital. *Id.* at 384. For the purposes of the present analysis, it is noteworthy that a decline in stable, long-term client relationships and greater fluidity would mean that a firm that wished to build firm-specific capital would logically, and perhaps necessarily, turn to means to build its reputation. The concept of first-tier firm was also foreshadowed by Karl Okamoto's study of the role of lawyers as reputational intermediaries in representing corporate clients in public offerings of securities. *See* Karl S. Okamoto, *Reputation and the Value of Lawyers*, 74 OR. L. REV. 15 (1995). He discusses segmentation among law firms based on reputation, categorizing the top fifty firms, mainly based in New York City, as the high reputation group. *Id.* at 38-41. This group would correspond roughly to "elite" law firms as used in this Article. More importantly, he notes the existence of four or five "super-elites," measured by their increasing superiority of revenue per lawyer over other law firms, as well as the longevity of such superiority. *Id.* at 40. The idea behind this group shares similarities with first-tier law firms as used herein.

firm in being recognized in its relevant market (i.e., regional, national, or global) by its constituencies as a first-tier firm. These are the firms that attract the best client matters as well as the best new attorneys (these firms typically do not utilize laterals, at least at the partner level).<sup>42</sup> To a much lesser degree, the benefits of being a first-tier firm might be loosely compared to those that accrue to being one of the “Big Four” accounting firms.<sup>43</sup> In the case of law firms, however, the definition of first-tier is vague and which firms meet this definition can be subject to disagreement. Although reputations tend to be sticky, there is nevertheless greater fluidity with the potential for both entry into and (unwilling) exit out of the first-tier group; firms on the edge may be particularly sensitive to either risks to their first-tier status or strategic opportunities to obtain or consolidate first-tier status.

The business and growth strategies of first-tier firms generally differ from those of other elite firms. The first-tier firms, at least in large domestic markets like the United States, do not seek to grow as fast as other elite firms and do not pursue strategies of numerous offices and areas of expertise (i.e., one-stop shopping) that might place their high profitability at risk.<sup>44</sup> They instead seek to maintain

42. See, e.g., Perceptions of Partnership, A.B.A. Young Lawyer’s Division, Spring Conference, May 2005, available at <http://www.abanet.org/ylde/library/miami05pdf/PerceptionofPartnership.pdf> (“Other firms, such as more traditional and ‘elite’ New York firms, do not hire lateral partners, fearing dilution of firm values and that ‘only those who train together from their earliest years as associates can rely on each other to maintain high standards of quality.’” (quoting Anthony Lin, *Cravath Hires Tax Partner, Its First Lateral in Decades*, N.Y. L.J., Mar. 11, 2005)).

43. This is not a perfect analogy, since, as noted in the text, the benefits are substantially less for first-tier law firms, which are a vaguer and more fluid group. All elite firms have a mixture of price-insensitive “high value-added services” and price-sensitive “commodity services,” with the first-tier firms being known exclusively for the more profitable high value-added services. As a result, first-tier and other elite firms typically service the same corporate clients, although providing a different mix of services. The classification of accounting firms is much more rigid, as firms outside the Big Four have very few large publicly held audit clients, and they have been generally unsuccessful in picking up such clients from the Big Four firms, despite the large number of corporate scandals and allegations of accounting fraud over the past few years. See, e.g., Diya Gullapali, *Grant Thornton Battles its Image: No. 5 Accounting Firm Struggles to Attract Major Audit Clients, Despite Misfortunes of Big Four*, WALL ST. J., June 9, 2005, at C1. This is largely due to sticky reputations and the unwillingness of top corporate officials to be required to “explain that decision” by choosing a non-Big Four firm. See *id.* Despite the differences, it is also very important for the top law firms to develop their reputations as first-tier firms so as to constitute a safe choice for significant corporate matters.

44. Sometimes, however, they resort to strategic behavior to maintain or enhance their first-tier status, with one of the most famous examples being Cravath’s sudden, significant raise in associate salaries in the mid 1980s. Michael H. Trotter, *Domino Effect of Associate Pay Hikes Could Cripple Some Firms*, FULTON COUNTY DAILY REP., Mar. 1, 2000 (“The next major run-up in associate salaries occurred in the mid-1980s. Cravath led the pack again with an increase in the starting salaries in 1986 from \$53,000 to \$65,000—a 22-percent increase in one year.”).

their highly profitable niches at the upper end of the market with their focus on high value-added services and to signal their superiority to the market. Consistent with this strategy, first-tier firms do not pursue mergers.

Other elite firms are more likely to compete through the pursuit of growth, both in terms of geographic area and areas of expertise, and to pursue mergers. This may be viewed as an attempt to capture the wide middle of the market in the hope of maintaining client relationships and volume of work, while at the same time eventually increasing high value-added services and making inroads into the profitable niche at the top of the market dominated by the first-tier firms.<sup>45</sup> Although this constitutes a plausible business strategy for non-first-tier firms, the fact remains that given a choice it is likely that any lawyer or firm would much rather be in the market position of a first-tier firm.

Outside the United States, however, first-tier law firms located in smaller domestic markets may pursue an international growth strategy. The leading London firms most notably fall into this category. In this regard, analyzing the response of first-tier firms in Europe and Asia to the merger offers of London firms is particularly interesting. In these markets the impact of a strategic decision, such as a merger, by a first-tier firm is of far greater significance than a similar action by another elite firm. A merger or other strategic action is much more likely to lead to defensive actions, such as mergers, by competitor firms. Thus, which firms engage in merger activity in a given market is an important factor in explaining and predicting both the reaction of competitors and whether mergers will become widespread in that market.

### III. THE UNITED STATES AND THE UNITED KINGDOM: NATIONAL OR GLOBAL MARKETS?

#### A. *United States*

The United States has the longest history of elite law firms and is the world's largest market for legal services. Elite law firms in the United States continue to be of primary importance, comprising some

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45. This concept of market partitioning—e.g., a manufacturer (such as Toyota) starting at the low of the car market in the United States and gradually improving to crowd out the profitable niche players at the top of the market—has become a popular one. See CLAYTON M. CHRISTENSEN, *THE INNOVATOR'S DILEMMA: WHEN NEW TECHNOLOGIES CAUSE GREAT FIRMS TO FAIL* 165 (1997). This is a relatively new concept for professional service industries, and it is very much an open question as to whether any law firms can imitate Toyota.



eighty of the firms in the Global AmLaw 100 ranked by revenue<sup>46</sup> and providing the dominant model of organization for legal service providers. The top U.S. law firms are listed in Table 2. Perhaps due to the large market for legal services and the correspondingly large number of prominent law firms, there is no universally accepted first-tier among the elite firms.<sup>47</sup> The top seven to ten firms are generally considered to be first-tier firms. Virtually all of them are based in New York, presumably due to its leading capital market, which requires (and pays top dollar for) high value-added services. Even a cursory glance at Table 2 strongly suggests that being in the first-tier correlates highly with firm profitability and reputation rather than firm size.

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46. See *The Global 100 Methodology*, AM. LAW., Nov. 2004, and the accompanying chart ranking firms by revenue. In the 2005 survey, U.S. firms comprised seventy-six of the Global 100 ranked by revenue (and sixty-eight of 100 ranked by the number of attorneys). See *The Global 100*, AM. LAW., Nov. 2005 at 111, 117.

47. During the last few years, a few law industry consultants and commentators have begun to refer to the top seven U.S. firms as the "Charmed Circle," which would correspond to the English group of first-tier firms which are well-known as the "Magic Circle." See, e.g., *International Law Firms: Trying to Get the Right Balance*, *supra* note 27 (stating that "[e]ach city has a small group of highly reputable firms whose list of blue chip clients marks them out as special. In New York, this group is seven strong and is known as the 'Charmed Circle.' In London, it is known as the 'Magic Circle' and consists of five leading firms..."). This Article does not use that term since to date its usage has not become widespread and, in fact, many U.S. lawyers have not yet heard of it.

**TABLE 2**  
**ELITE AND FIRST-TIER FIRMS IN THE UNITED STATES**

	<b>Profits per Partner (PPP) (AmLaw 100 PPP Rank/Revenue per Lawyer Rank)</b>	<b>Gross Revenue (AmLaw 100 Rank)</b>	<b>Vault 100 Reputational Rank</b>	<b>Number of Attorneys (AmLaw 100 Rank)</b>
Watchell, Lipton*	\$3,500,000 (1/1)	\$431,000,000 (44)	1	197 (100)
Cahill Gordon	\$2,455,000 (2/7)	\$227,000,000 (85)	47	242 (99)
Sullivan & Cromwell*	\$2,350,000 (3/2)	\$833,000,000 (10)	3	589 (52)
Simpson Thacher*	\$2,330,000 (4/5)	\$691,000,000 (19)	6	632 (44)
Cravath, Swaine*	\$2,205,000 (5/3)	\$455,000,000 (37)	2	389 (87)
Paul, Weiss	\$2,155,000 (6/6)	\$504,000,000 (30)	13	480 (65)
Cadwalader, Wickersham	\$2,110,000 (7/13)	\$416,000,000 (46)	35	486 (64)
Davis Polk*	\$2,005,000 (8/4)	\$604,500,000 (23)	5	538 (57)
Kirkland & Ellis	\$1,975,000 (9/8)	\$835,000,000 (9)	11	897 (18)
Milbank, Tweed	\$1,900,000 (10/11)	\$431,500,000 (43)	25	480 (65)
Schulte Roth	\$1,815,000 (11/15)	\$292,000,000 (69)	79	354 (93)
Skadden, Arps*	\$1,735,000 (12/10)	\$1,440,000,000 (1)	4	1,554 (4)
Cleary, Gottlieb*	\$1,715,000 (13/15)	\$695,000,000 (17)	7	844 (22)
Weil, Gotshal	\$1,700,000 (14/14)	\$905,000,000 (8)	9	1,080 (11)
Wilkie Farr	\$1,635,000 (15/17)	\$416,000,000 (46)	32	507 (61)
Gibson, Dunn	\$1,515,000 (16/8)	\$693,000,000 (18)	17	745 (29)
Debevoise & Plimpton	\$1,510,000 (17/12)	\$478,500,000 (34)	14	536 (58)
Latham & Watkins	\$1,405,000 (18/20)	\$1,206,000,000 (3)	8	1,502 (5)
O'Melveny & Myers	\$1,310,000 (19/25)	\$697,000,000 (16)	19	910 (15)
Dechert	\$1,235,000 (20/52)	\$441,500,000 (40)	60	678 (34)
<b>*First-Tier Firms</b>				
Sources: The American Lawyer (The AmLaw 100, July 2005); Brook Moshan Gesser, et al., The Vault Guide to the Top 100 Law Firms, 2005 (7th ed. 2004).				

In the United States it appears there has been a wave of mergers among elite law firms since the late 1990s.<sup>48</sup> The number of mergers has continued at a relatively high level over the last decade under a variety of economic conditions, and the size of the firms resulting from these mergers has continued to increase. Although some industry commentators cite the activities of consultants as having provided an important impetus to the beginning of the merger boom, now most believe that the merger boom has become self-sustaining.<sup>49</sup>

Although difficult to measure, the three reputational elements introduced earlier appear to have played a significant role in creating and, in particular, sustaining the merger boom. One can certainly find any number of quotations to the effect that: (i) the true purpose of a merger is to get on (or stay on) the short list of large corporate clients and send a signal on firm quality to such desirable clients, rather than to achieve any economies of scale,<sup>50</sup> (ii) the clearest measure of a firm's success is its ability to attract (and retain) lateral partners and practice groups,<sup>51</sup> and (iii) a firm's success can be measured by its ability to attract and retain the most highly credentialed law students as new associates.<sup>52</sup> One can also find

48. See *supra* note 16 and accompanying text.

49. See, e.g., Anthony Lin, *Law Firm Merger Consultants Race for Booming Business*, N.Y. L. J., June 24, 2002 (describing the busy activities of law firm consultants in advising on law firm mergers, but also stating that law firms have become quite conscious of competitive pressures and mergers, so that "[i]f consultants previously played an important role in proselytizing the consolidation of the legal industry, there is little need for such cheerleading now").

50. See, e.g., Lisa Stansky, *The Aftermath of Mergers can be Layoffs, Departures*, NAT'L L.J., Nov. 18, 2002 (quoting legal consultant Ward Bower of Altman Weil Inc.).

51. See, e.g., Bill Myers, *Lateral hiring finds favor in Chicago firms*, CHI. DAILY L. BULL., Apr. 18, 2005, available at <http://www.kellogg.northwestern.edu/news/hits/050418cdlb.htm> (quoting Gary M. Wolfson, partner of consulting firm Blackman, Kallick, as stating that "[f]rankly, the way to judge a firm's success is by how well they've been able to attract significant laterals, not just in their overall growth").

52. This is well illustrated by the competition among elite firms over raising and maintaining the compensation for new associates. See *supra* note 35, 44 and accompanying text. Elite law firms compete hard to attract the top candidates with prestigious credentials. See, e.g., Lindsay Fortado, *In Focus: Law Schools—Top 50 Firms Hire Most from Big Names, Prominent Law Schools Feature High on the List*, NAT'L L.J. Sept. 12, 2005 (noting that the results of its first ranking of law schools based on hiring by the top fifty law firms was "strikingly similar" to law school rankings that appear in *U.S. News & World Report*). These elite law school credentials do not correlate closely with lawyering skills, but a firm's ability to attract such prestigious new attorneys is a further sign of its elite status and serves as a useful signal of its quality with respect to the firm's other constituencies. Wilkins and Gulati also make this point concerning the poor correlation between elite firm hiring criteria and lawyering skills. See Wilkins & Gulati, *supra* note 21, at 1653 n.226; David B. Wilkins & G. Mitu Gulati, *Why Are There So Few Black Lawyers in Corporate Law Firms? An Institutional Analysis*, 84 CAL. L. REV. 493, 524-27 (1996); see also Tom Ginsberg & Jeffrey A. Wolf, *The Market for Elite Law Firm Associates*, 31 FLA. ST. U. L. REV. 909, 956 (2003-04) (noting "the (perceived) benefits of decentralized recruiting for

numerous law firm actions that support these statements and are clearly intended to signal reputation to these constituencies.

Similarly, with respect to herd behavior there are perhaps even more quotations echoing the conventional wisdom that a law firm needs a national platform and credible mass.<sup>53</sup> It is safe to say this trend has reached every nationally significant business center in the United States. This is illustrated by a series of mergers over the last few years involving firms in the last stronghold of traditional regionalism, Boston, following the first major merger several years ago by Dana Bingham.<sup>54</sup> This process has progressed to the point that there are almost no remaining mid-sized general service firms in New York or Los Angeles, or more recently, regulatory firms in Washington, D.C., which might logically provide an entry point for expansion to a national platform.

The importance of first-tier firms is more directly observable. Despite the merger wave, none of the top ten firms listed in Table 2 has ever engaged in a merger. It is the other elite firms that must consider their size and platform. Since most of them are based outside of New York, they must also consider the necessity of a New York office to be recognized as having a national presence.<sup>55</sup> Even

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signaling reputation and quality” as one factor that explains why there is a decentralized system for associate recruiting at elite law firms in the United States as opposed to a centralized system as in Canada).

53. See, e.g., Bruce E. Aronson, *Law Firm Mergers: Is Bigger Really Better?*, CREIGHTON LAWYER, Spring 2006 (noting that in the wave of mergers of large firms, many firms justify such mergers by claiming a need for a national platform and a credible mass); Lisa Stansky, *The Aftermath of Mergers Can Be Layoffs, Departures*, NAT'L L. J. Nov. 18, 2002 (stating that the goals cited by Chicago's Katten Muchin Zavis and New York's Rosenman & Colin for their merger were “gaining a ‘national footprint’ and wooing laterals” (Rosenman) and “looking for critical mass” (Katten Muchin)).

54. A number of traditional, well-known firms in Boston were among the last holdouts against the conventional wisdom that bigger is better and that firms require a national platform. But the firm now known as Bingham McCutchen LLP began an aggressive expansion program in 1999. Also, within a few years the old-line Boston firm of Hill & Barlow dissolved when a group of important partners left for Piper Rudnick. In the last few years all of the major Boston firms have merged to become national firms. See, e.g., Martha Neil, *Two Century-Old Firms Tie the Knot: Changing Markets in Boston, IP Practice Lead to Merger*, A.B.A. J. E-REPORT, Nov. 19, 2004 (discussing merger between Ropes & Gray and Fish & Neave).

55. As noted earlier, it is now quite usual for a law firm to first decide that it wants to do a merger and then systematically screen and pursue merger partners until the desired result is achieved. At first blush this may appear to represent proactive business strategizing. However, the reality for most of the firms is that they are reacting to the now widespread market perception that regional firms are, by definition, no longer considered to be among the top law firms. Even some conservative regional firms that are not elite firms in the Am Law 100 are now in the process of “going national.”

A typical example of the above phenomenon is reflected in a comment by a partner of a regional Los Angeles-based firm about acquiring a firm in New York is: “When you go to New York, you get better name recognition and you're perceived as being more

those firms that have had success in New York do not generally engage in direct competition with the first-tier firms.<sup>56</sup> And a first-tier firm will go to great lengths to combat any perception that it is in danger of falling out of the first tier.<sup>57</sup>

There has been substantial growth in the number of overseas offices and attorneys of elite law firms over the last decade.<sup>58</sup> Nevertheless, the rich U.S. domestic market and U.S. firms' emphasis on profitability have made first-tier firms and some other elite U.S. firms cautious of international expansion. A typical international strategy by these firms would be one of selective overseas expansion, having a limited number of overseas offices in major financial centers with a focus on giving advice on U.S. law and cross-border transactions in high value-added areas such as capital markets and M&A transactions. A few first-tier firms, such as Cravath, have essentially eschewed international offices altogether, claiming that the best lawyers will also obtain top cross-border work and that overseas offices are difficult to administer and monitor for quality.<sup>59</sup> Conversely, some elite firms, such as White & Case and Jones Day, have embraced a "going global" strategy, which encompasses an

national." Alexei Oreskovic, *Sheppard's Pie*, RECORDER, May 13, 2003, available at <http://www.sheppardmullin.com/images/pubs/pub211.pdf> (quoting Joseph Coyne Jr., a partner and executive committee member of Sheppard, Mullin, Richter & Hampton).

56. See Andrew Longstreth, *Princes of the City: Twenty Years After Arriving in Manhattan, Latham and Watkins Now Plays in the Highest Tier of New York Firms. Is It Too Late for Others? Not If They Can Follow Latham's Four Rules*, AM. LAW., June 2005, at 48 (questioning whether other firms attempting to move into the New York City legal market will achieve similar success as firms such as Latham & Watkins did when it opened its New York City office twenty years ago).

57. This has been the recent history of Shearman & Sterling. See, e.g., Anthony Lin, *No. 1 Task for Shearman Leader: Keeping the Firm in the Top Tier*, N.Y. L.J., Feb. 24, 2006 (discussing Shearman & Sterling's strategies for maintaining its top-tier reputation despite internal turmoil, layoffs, and lack-luster profitability compared to peer firms); Anna Schneider-Mayerson, *'Shearminations': Big Firm Urging Partners to Leave*, N.Y. OBSERVER, Apr. 11, 2005 (analyzing Shearman & Sterling's encouragement of partners to leave the firm).

58. See, e.g., Neal Solomon, *In Focus: Business of Law, Economic Principles Drive Mergers Among U.S. Firms- Most Recent Law Firm Growth has Occurred Due to Branching via M&A*, NAT'L L.J., Sept. 26, 2005 ("[T]he last 10 years have . . . witnessed an attempt by major U.S. firms to expand into international markets."). They have been able to expand their international business because of both the significant opportunity presented by the large expansion of overseas trade and investment by U.S. multinational corporations and by utilizing their natural advantages—their ability in the English language, expertise in U.S. law (which is the governing law in many international transactions), importance of the U.S. financial markets, and expertise in sophisticated financial and M&A transactions. *Id.*

59. See, e.g., *In Brief—Cravath Swaine Elects a New Presiding Partner*, NAT'L L. J. Nov. 21, 2005 (describing Cravath as "one of the most conservative [law firms], largely eschewing international expansion").

extensive global network of offices that provide full service on local law matters in addition to big ticket cross-border work.<sup>60</sup>

A few firms have gone global through transatlantic mergers with English firms, either being acquired by a first-tier firm English firm (e.g., Rogers & Wells) or acquiring a second-tier elite U.K. firm (e.g., Mayer Brown). To date no U.S. first-tier firm has agreed to an international merger, despite reported ardent wooing by the top English firms.<sup>61</sup> The first and best-known transatlantic merger was the 2000 acquisition of Rogers & Wells by London's Clifford Chance, a first-tier U.K. firm. Rogers & Wells, which apparently grew frustrated by its inability to break into the first tier, instead adopted a going global strategy.<sup>62</sup> This strategy views the entire world (or at least substantial portions of it) as the relevant market and essentially seeks to execute a middle market strategy<sup>63</sup> with respect to multinational corporate clients who are present in numerous markets around the globe.

Although the combination of Clifford Chance and Rogers & Wells was very big news, it did not lead to any other combinations involving first-tier firms, and the success of the merger has been called into question.<sup>64</sup> Several subsequent transatlantic mergers have all

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60. See, e.g., Anthony Lin, *For White & Case, Global Expansion Was the Easy Part*, N.Y. L. J. Jan. 12, 2007 (describing how the 2,000 lawyer White & Case established a global network of almost 40 offices worldwide and its present challenge of having more clients utilize its network).

61. See, e.g., *Law Firms: The Bigger the Better?*, ECONOMIST, Dec. 11, 2004, at 60 (stating that three of the leading U.K. firms have tried but failed to find a suitable partner among the top U.S. firms); see also Anthony Lin, *Jones Day is Merging with Gouldens*, N.Y. L.J., Feb. 10, 2003 (stating that "[t]he efforts of larger British firms to secure combinations with major New York firms have largely met with little interest . . ."). Interviews conducted for this Article have confirmed that two of the three magic circle firms cited in the article from *The Economist* have made offers to first-tier U.S. firms, which were rejected, and that these same U.K. firms have also declined to follow through on merger discussions with non-first-tier U.S. elite firms that had indicated an interest in accepting a merger offer. This result is consistent with predictions of first-tier firm behavior based on the prior discussion in Part II(C) (and also consistent with Groucho Marx's famous quip that he sent a wire to a country club announcing his resignation because "I don't want to belong to any club that will accept me as a member."). In fact, the unwillingness to consider a merger offer from a first-tier English firm might well provide a good functional definition of what constitutes a first-tier U.S. firm.

62. One important Rogers & Wells partner stated, "We were one of the 20 firms that claimed to be the 11th-best firm in New York." See Anthony Lin, *Grappling with Post-Merger Culture Shock*, N.Y. L.J., Nov. 26, 2002 (quoting John Carroll, who became Clifford Chance's managing partner for the Americas following the merger).

63. See *supra* note 45 and accompanying text.

64. At the time of the merger the firm generally adopted Clifford Chance's lockstep compensation system but paid much higher compensation to a limited number of rainmakers from the former Rogers & Wells. Susan Beck, *Still the Biggest, but Still Bailing: Four Years After a Merger, Clifford Chance Expected to Hit Calmer Waters; The Past Has Brought Anything But*, Am. Law., Dec. 1, 2004. In the following five years, some thirty partners have left the New York and Washington, D.C. offices, many

involved combinations of non-first-tier elite firms on both sides of the Atlantic who embraced a similar expansionist, middle market strategy. These mergers have not had a significant effect on the U.S. market to date and have provoked no competitive reaction from first-tier U.S. firms.

### B. United Kingdom

Although the image of elite English firms is one of a commitment to globalization and broad international networks of offices, this is a relatively recent and limited phenomenon. Unlike U.S. firms, law firms in London's financial district, the City, remained small until the 1980s; legal restrictions kept members in all partnerships to a maximum of twenty persons until 1967.<sup>65</sup> Deregulation in the 1980s, represented by the "big bang" in 1986, spurred dramatic law firm growth and expansion.<sup>66</sup> The elite firms, all centered in London, represented large English clients and acted as national firms; they did not generally branch into other cities and there was no need to merge with regional firms to attain national status.

The top firms dominate the legal services industry to a far greater extent than the leading firms in the United States (see Table 3).<sup>67</sup> Given the smaller market for legal services, there is a smaller number of elite firms in the United Kingdom than in the United States.<sup>68</sup> The five first-tier firms, widely referred to as the "magic circle,"<sup>69</sup> include four out of five of the largest law firms in the United

of them reportedly due to the compensation system. See, e.g., Terry Carter, *A Delicate Balance: Law Firms Seek Ways to Please Superstars Without Demoralizing Others*, A.B.A. J., Mar. 2005, at 28, 29. Another source has claimed that during roughly the same period a total of 271 partners have left Clifford Chance worldwide, including eighty in the United States. See *Law Firms: The Bigger the Better?*, supra note 61.

65. For an overview of the history of the development of elite firms in the United Kingdom, see, e.g., John Flood, *Megalaw in the U.K.: Professionalism or Corporatism? A Preliminary Report*, 64 IND. L.J. 569 (1989).

66. See, e.g., *id.* at 581 (stating that "[t]he Big Bang of 1986 unleashed a dramatic call for specialized legal services as the securities industry expanded").

67. The five magic circle firms accounted for 38% of the total revenue of the top 100 U.K. firms in 2002, up from 37% in 2001. See *2002: The Silver Age*, THE LAWYER, available at [http://www.the-lawyer.co.uk/LawyerNews/top100/editorialpages/overview\\_silverage.asp](http://www.the-lawyer.co.uk/LawyerNews/top100/editorialpages/overview_silverage.asp) (last visited Apr. 23, 2007). In 2004 the Big Four among the magic circle accounted for 29% of total revenue. See Catrin Griffiths, *London Overview*, UK 100 Annual Report 2005, THE LAWYER, available at <http://www.thelawyer.com/uk100/2005/london.html> (last visited Apr. 23, 2007).

68. In 2004 the smallest firm in the AmLaw 100 had \$227 million in revenue (see Table 2), which would place it at roughly number twenty in The Lawyer U.K. 100. See *id.*

69. One of the leading U.K. legal publications, Legal Business, also includes Herbert Smith within the magic circle, making it six firms. See, e.g., Legal Services, City Business Series, International Financial Services—London, March 2005, Chart 9, at 10, available at [http://www.ifsl.org.uk/pdf\\_handler.cfm?file=CBS\\_Legal\\_Services\\_](http://www.ifsl.org.uk/pdf_handler.cfm?file=CBS_Legal_Services_)

Kingdom (the Big Four) and in the world, based on revenue or the number of lawyers.<sup>70</sup>

**TABLE 3**  
**Elite and First-Tier Firms in the United Kingdom**

	<b>Profits per Partner (Global 100 Rank)</b>	<b>Gross Revenue (Global 100 Rank)</b>	<b>Number of Attorneys (Global 100 Rank)</b>
Slaughter and May*	\$1,925,000 (9)	\$531,500,000 (8)	575 (85)
Linklaters*	\$1,545,000 (16)	\$1,475,500,000 (2)	2,013 (6)
Herbert Smith	\$1,480,000 (19)	\$485,500,000 (9)	798 (39)
Freshfields Bruckhaus Deringer*	\$1,285,000 (22)	\$1,429,500,000 (3)	2,115 (5)
Allen & Overy*	\$1,200,000 (26)	\$1,221,000,000 (4)	2,263 (3)
Clifford Chance*	\$1,195,000 (27)	\$1,675,500,000 (1)	2,480 (2)
Ashurst	\$1,040,000 (40)	\$368,500,000 (11)	613 (69)
DLA	\$980,000 (44)	\$590,000,000 (6)	1,482 (10)
Lovells	\$785,000 (62)	\$671,000,000 (5)	1,163 (18)
Norton Rose	\$780,000 (63)	\$376,000,000 (10)	778 (43)
Addleshaw Goddard	\$740,000 (68)	\$255,000,000 (16)	578 (83)
CMS Cameron McKenna	\$705,000 (72)	\$299,000,000 (13)	613 (69)
Simmons & Simmons	\$705,000 (72)	\$359,500,000 (12)	728 (46)
*First-Tier Firms			
Source: The American Lawyer (The Global 100, Nov. 2005)			

In many respects the London legal services market feels quite familiar to U.S. lawyers with large and rapidly growing corporate law firms, a focus on profitability and corporate management, and well-known firm ranking tables provided by an extensive legal press. As in the United States, there is client consolidation; accompanied by increased law firm competition and instability. There is indirect evidence of reputational signaling<sup>71</sup> and herd behavior; and more

2005&CFID=680776&CFToken=98022887 (noting that Legal Business data includes Herbert Smith among magic circle firms).

70. Despite U.S. firms dominating the Global 100 generally (*see supra* note 46), the English Big Four firms occupy four of the top six positions by revenue, and English firms occupy five of the top seven spots by number of lawyers. *See The Global 100*, AM. LAW., Nov. 2005, at 111, 117.

71. The English legal press is replete with familiar-sounding stories related to law firm competition and reputational signaling, such as the following: the rapid movement of lateral partners as a result of raids; partner compensation, *see, e.g.,*



direct evidence of the importance of first-tier law firms. This has not resulted in a wave of domestic mergers (since there is no need for a merger to create a national firm based in London) but rather a focus on international strategy and mergers. One combination in particular—the 1987 merger between Clifford Turner and Coward Chance to form Clifford Chance—has roiled the U.K. legal services industry and has also had significant international consequences.

Clifford Chance brought to the market its strongly-held views on global competition, emphasizing the idea that over time only a half-dozen global firms would survive and it would make certain to be one of them. According to this view, competition in the future would be in the international market between English and U.S. firms. The English firms, which were not bound by longstanding traditions as large firms, were responding more flexibly and creatively to the new global environment. This view ultimately resulted in the three-way merger, announced in 1999, between Clifford Chance, Rogers & Wells, and Pindar of Germany, with Clifford Chance proclaiming that it was the “first global law firm.”<sup>72</sup>

Initially, Clifford Chance, whose predecessor firms were both regarded as non-first-tier elite firms, had little impact on London’s leading firms. However, within just a few years Clifford Chance succeeded in gaining recognition as having joined the magic circle of first-tier firms. It is a highly unusual event for a newcomer to be clearly admitted to the first tier, and it had far-reaching consequences. Any strategy utilized by a firm to achieve such an

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Husnara Begum, *A&O to Shake Up Partner Reviews*, THE LAWYER, Sep. 12, 2005, available at <http://www.thelawyer.com/cgi-bin/item.cgi?id=116587&d=11&h=24&f=23>; partner firings and firm restructurings, see, e.g., Gemma Westacott, *Linklaters Offloads Senior Partners in Bid to Kickstart Faltering Projects Practice*, THE LAWYER, Sep. 12, 2005, available at <http://www.thelawyer.com/cgi-bin/item.cgi?id=116589&d=122&h=24&f=46>; de-equitization of partners accompanied by accusations of attempts to unfairly influence a firm’s profit per partner rankings, see, e.g., Catrin Griffiths, *From Profit per Equity Partner to Earnings per Partner: A New Indicator of Financial Health*, UK 100 ANN. REP. 2005, available at <http://www.thelawyer.com/uk100/2005/eppvpep.html>; and firms advertising working conditions and changes to the partner track in an effort to attract the most highly credentialed new associates, see, e.g., Matheu Swallow, *Career Development Special*, THE LAWYER, May 12, 2005, available at <http://www.thelawyer.com/cgi-bin/item.cgi?id=115439&d=122&h=24&f=46>; Husnara Begum, *Linklaters’ Trainees get 40 per cent Maintenance Hike*, THE LAWYER, Sep. 5, 2005, available at <http://www.thelawyer.com/cgi-bin/item.cgi?id=116533&d=11&h=24&f=23>.

72. Clifford Chance was quick to point to its global strategy as important to its growth and profitability. See Press Release, Clifford Chance, Clifford Chance Announces Record-Breaking First-Year Results (July 30, 2001), available at <http://www.cliffordchance.com/uk/news/press-releases/template.asp?file=/uk/news/pr> (quoting its chief executive officer as saying: “The results have exceeded expectations and are proof positive that the calculated, first-mover risk we took in going global is paying off.”). *But see supra* note 64 and accompanying text (discussing the uncertain results and impact of the merger to date).

exalted (albeit ill-defined) status is perceived to be highly successful and is likely to produce a competitive reaction (i.e., herd behavior) both from other first-tier competitors and from firms with hopes of gaining entrance to the first tier.

In the case of Clifford Chance, this meant responding to its “going global” international strategy.<sup>73</sup> By the mid-1990s the other elite English firms began to scramble to play catch up with Clifford Chance. In the run-up to the creation of the Euro zone in 1999, with the prospect of a large, unified European economy, deeper capital markets, new privatization programs, and a pan-European boom in M&A activity, most of the magic circle firms bought into the idea of one-stop shopping in Europe. Faced with a limited number of top corporate law firm candidates in most continental countries, in the late 1990s U.K. firms scrambled to find merger partners and establish a strong continental presence. Slaughter & May, the smallest member of the magic circle, was the exception to this trend, as it eschewed the establishment of a global network of offices represented by mergers and formal alliances for more informal “best friends” relations with leading local firms in various jurisdictions.<sup>74</sup>

The pursuit of an expansionist international strategy by four of the five magic circle firms contrasts sharply with the high profitability/non-expansionist (or highly selective expansionist) strategy of first-tier firms in the United States. Both the London and New York firms insist that their opposing strategies are driven by client demand.<sup>75</sup> This clear difference in approach has provided

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73. Despite much talk in the 1980s of “going international” following the big bang, English firms basically produced a domestic legal product. Utilizing advantages similar to those enjoyed by U.S. firms—the English language, English law, expertise in financial markets and global clients—English firms also marketed their services internationally on a fairly extensive basis. English language documentation was gaining importance. English firms maintained offices in former colonies, particularly in Hong Kong (where solicitors could be admitted to the local bar without examination) and the Middle East, and with the approach of the integration of the European market in 1992, Brussels and Paris as well. It was not until the success of Clifford Chance that other magic circle firms began to adopt a clearly international strategy.

Today the Big Four have between 45% and 65% of their lawyers based outside of London, compared with 10-20% for other London firms and a wider range of under 10% to up to 25% for U.S. firms. See, e.g., *International Financial Services—London*, *supra* note 69.

74. See, e.g., Michael D. Goldhaber, *The Global 100: Just Friends?*, AM. LAW., Nov. 2002 (“By ‘best friendships,’ Slaughter means active, but nonexclusive, crossreferral relationships.”); Ben Halleman, *The Global 100: Modern English--Slaughter and May Stands by its Traditions, But There's Nothing Old-School About its Profits or its Approach to Working With Other Law Firms*, AM. LAW., Oct. 2, 2006, at 125 (describing Slaughter and May’s non-expansionist policy and the operation of its friends network)..

75. See, e.g., Jean Eaglesham, *Comment and Analysis: Scales of Justice: UK Firms see Cross-border Mergers as the Best Way to Address the Global Market for Legal Services. But Their US Counterparts are Unconvinced that Size is a Virtue*, FIN. TIMES,

fertile grounds for commentators to weigh in with their views on which strategy is correct.<sup>76</sup> To the extent that the U.K. firms may have been influenced by the big accounting firms' stated intention to provide global legal services in the late 1990s, it is worth noting that the accounting firms' model proved to be unsuccessful for legal services.<sup>77</sup> It may be understandable, that given a smaller domestic market, English firms would be tempted to take a broader view of the relevant market in order to compete with the top U.S. firms. This is essentially similar to the middle market strategy employed by the few internationally expansionist (second-tier) U.S. firms. It depends on the same substantial overseas investment, which implies a lower level of profitability, at least in the short term. The ultimate success of this internationalist strategy, which may depend to a large extent on whether the strategy is correct in identifying a global market as the relevant market for major law firms, will not be known for years.

For the purposes of this Article, it is important to note that this magic circle strategy differs significantly from the prior discussion of first-tier firms in the United States. The one magic circle firm that has not pursued an expansionist strategy, Slaughter & May, is consistently the most profitable firm in the United Kingdom.<sup>78</sup> The tier of firms just below the magic circle currently matches the profitability levels of the Big Four international expansionist firms within the magic circle, although with far less stability.<sup>79</sup> The legal

July 31, 2001 (noting that both sides claim to have the support of their clients for their differing strategies and that these clients include the same pool of investment banks).

76. See Partha Bose, *The Tragic Circle, Europe's Elite Law Firms Have Grown Exponentially over the Last Few Years. So What Does the Future Hold for Them? Possible Extinction*, AM. LAW, Nov. 2005, at 102 (arguing that U.S. firms will outcompete English firms, as the latter are plagued by overcapacity, lack of growth in their main markets, inefficient management, and penetration by U.S. transactional lawyers into European markets). *But see* Tony Williams, *The Empire Strikes Back, U.S. Firms Missed Critical Opportunities that will Keep Top U.K. Firms Competitive for the Foreseeable Future*, AM. LAW., Feb. 2006, at 87 (arguing that over the long term, the large international capacity of U.K. firms is a big plus, as clients are increasingly demanding greater size, while the top U.S. firms are reluctant to compete internationally by expanding beyond their profitable market in New York).

77. All of the Big Four accounting firms have significantly downsized their ambitious legal services programs or exited the market completely. See *International Law Firms: Trying to Get the Right Balance*, *supra* note 27. Ironically, in the late 1990s the large English law firms discounted any serious competition in legal services from the newly expanding accounting firms by stressing that the traditional law firms' higher quality and expertise far outweighed the accounting firms' global web of offices and wide variety of services. See *id.* Now the English firms find themselves on the other side of the argument, stressing the benefits of globalization, while the New York first-tier firms stress quality and expertise. See *id.*

78. See, e.g., Table 3 (showing Slaughter & May with highest profits per partner in the U.K. in 2005).

79. *The Lawyer* reported that for 2004 average profit figures were nearly identical for magic circle firms and the next tier it dubs "silver circle" firms, whether measured by profit per equity partner (£712,000 versus £707,000) or by revenue per

press in the United Kingdom seems ambivalent about profitability versus globalization as a measure of evaluating the leading English firms. Is Slaughter & May the “odd man out” or the only true first-tier firm in London?<sup>80</sup> Can the Big Four firms sustain their reputations as first-tier firms, with all the resulting benefits, by pursuing a strategy that is not based on maintaining the highest profitability?

The answer remains to be seen, but there are signs that the international expansionist strategy may be losing some traction. A number of the English firms just below the magic circle at first imitated, but have now retreated from, such a strategy.<sup>81</sup> A renewed focus on servicing U.K. clients is appropriate in light of the strong inroads that U.S. firms have made on the magic circle’s home turf of London over the past few years.<sup>82</sup> The continuing difference in profitability levels between elite U.S. and U.K. firms has been a contributing factor to the ongoing success of U.S. firms in attracting lateral partners for their London offices from their English rivals.<sup>83</sup>

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lawyer (£358,000 versus £357,000). See CATRIN GRIFFITHS, INTRODUCTION-THE SILVER CIRCLE, UK 100 ANN. REP. 2005, available at <http://thelawyer.com/uk100/2005/intro.html> [diagram available at [http://www.thelawyer.com/images/uk100/2005/p6\\_venn.gif](http://www.thelawyer.com/images/uk100/2005/p6_venn.gif)]. However, the firms occupying the tier just below the magic circle “changed year by year.” *Id.*

80. On one hand, *The Lawyer* essentially removed Slaughter & May from the magic circle in its 2005 annual report, stating instead that the firm overlapped between the magic circle and the next tier of firms, the silver circle. *Id.* As justification for this classification, it noted that Slaughter & May stood out from the other Big Four magic circle firms, noting that it was “not fighting the same global battles” as the other leading firms, and was essentially a domestic firm (with 89% of its revenue coming from London and with a culture and economic model similar to that of a domestic firm). *Id.* On the other hand, *The Lawyer* also noted that the firm “has the same international kudos as the magic circle firms, it slugs it out with Linklaters for control of the FTSE 100 and sits at the apex of the City . . .” *Id.* In addition, *The Lawyer* named Slaughter & May its law firm of the year for 2004 and called it “everyone’s favorite elite firm.” See Griffiths, *supra* note 67. From the perspective of this Article’s functional definition of a first-tier firm, one could argue the opposite—that Slaughter & May was the *only* true first-tier firm. Its emphasis on profitability (rather than expansion) and on its traditional firm culture and management would lend strong support to such a view. The U.K. market view may have been skewed by the emergence of Clifford Chance’s globalism and what appears to be herd behavior by the other first-tier firms in imitating it, thus leaving Slaughter & May isolated in its strategy among the top firms.

81. These firms are reported to include Norton Rose, Simmons and Simmons, Denton Wilde Sapte, and to a large extent, CMS Cameron McKenna. See GRIFFITHS, *supra* note 75.

82. It is reported that seventy of the AmLaw 100 firms now have some presence in London and that in 2004 for the first time the top thirty U.S. firms based in London cut into the revenue of the top thirty U.K. firms. See GEMMA WESTACOTT, INTERNATIONAL OVERVIEW, UK 100 ANN. REP. 2005, available at <http://www.thelawyer.com/uk100/2005/international.html>.

83. *The Lawyer* reports the average profitability per equity partner for the top thirty international (i.e., U.S.-based) firms of £789,900 compared to a figure of

As noted previously, there have been no transatlantic mergers involving first-tier firms following Clifford Chance's combination with Rogers & Wells, although second-tier mergers have continued with seemingly mixed results.<sup>84</sup>

#### IV. INTERNATIONAL MERGERS AND ALLIANCES: THE EXAMPLES OF GERMANY AND AUSTRALIA

##### A. Germany

With Europe's largest economy, Germany has always had a significant legal market, and in recent years its importance has continued to grow with the advent of an increasingly unified European market. Traditionally, German lawyers worked in small firms that emphasized the autonomy and professionalism of individual lawyers and their close relationships with clients.<sup>85</sup> Legal restrictions limited law firms to practicing in a particular state under Germany's federal system.<sup>86</sup> With the abolition of these restrictions in 1989, a series of domestic mergers created a number of national firms, dominated by the first-tier "Big Six" firms. A few foreign firms also began to enter the market in the early 1990s, after the relaxation of restrictions on the activities of foreign lawyers.

Gradual changes among German firms throughout the 1990s prepared the way for the dramatic international merger explosion, which later occurred in 1999-2000. As in the United States in the 1970s and 1980s, German clients gradually expanded their businesses, both nationally and globally, and became more sophisticated purchasers of legal services. National German firms

£493,000 for the top thirty U.K. firms. *See id.* Similarly, although the City 50 (ranked by revenue) contains a total of fourteen U.S.-based firms, seven of the top ten firms based on revenue per partner (a measure of profitability) are based in the United States. *See* CATRIN GRIFFINS, LONDON OVERVIEW, UK 100 ANN. REP. 2005, available at <http://www.thelawyer.com/uk100/2005/london.html>.

For examples of recent notable partner laterals, see, e.g., WESTACOTT, *supra* note 82.

84. With the new interest of U.S. firms in the London market and the increase in trans-Atlantic mergers, the number of attractive mid-sized English merger candidates in London has become scarce (similar to the situation in the United States with New York and Los Angeles). *The Lawyer* judges Mayer Brown Rowe & Maw as the biggest success story among the second-tier mergers and Jones Day's combination with Goulden as having been relatively unsuccessful (measured, in part, by the number of partner departures during 2004). *See* WESTACOTT, *supra* note 82.

85. *See, e.g.,* Martin Henssler & Laurel S. Terry, *Lawyers without Frontiers—A View from Germany*, 19 DICK. J. INT'L L. 269, 274 ("Until recently, a typical German law firm was rather small, rooted in regional markets and focused on continental business.").

86. *See id.* (noting that prior to 1989, German law prohibited firms from having more than one office, resulting in a regional focus for these firms).

had been formed not simply by a single merger of two regional firms but by a series of mergers (often four to six transactions) that had already disrupted firms' traditional local/regional emphasis and relationships.<sup>87</sup> The establishment of local offices by a few U.S. and U.K. firms earlier in the 1990s had introduced both the ideas and style of Anglo-American firms, including the hiring of lateral partners from German firms.

The major U.K. firms were attracted to the European continent, particularly the German market, after the announcement of a series of changes scheduled for 1999, including the adoption of the Euro and a unified European market, a predicted pan-European M&A boom, and location of the European Central Bank in Frankfurt.<sup>88</sup> Around that time, the gradual growth and internationalization of German clients was punctuated dramatically by Daimler Benz's choice of Shearman & Sterling to represent it for the German legal side of its merger with Chrysler in 1998.<sup>89</sup> It quickly became a common perception that the national German firms could not compete globally with the major U.K.- and U.S.-based international firms. The feeding frenzy following Clifford Chance's dramatic three-way merger with the first-tier firm Pundar Volhard Weber & Axster in Germany and Rogers & Wells in New York in 2000 resulted, in less than a year, in the near disappearance of independent national German firms (see Table 4). Only one first-tier independent German law firm remains, as all of the others merged into (or in one case entered into a formal alliance with) large international firms.<sup>90</sup>

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87. See, e.g., Laurel S. Terry, *The Future of the Profession: A Symposium on Multidisciplinary Practice—German MDPs: Lessons to Learn*, 84 MINN. L. REV. 1547, n. 121 (2000) (citing the 1999/2000 JuVe Handbuch as showing charts diagramming the multiple mergers which formed the national German firms).

88. All of these changes have led to at least one prediction that “[i]n ten years’ time, the German market will be more significant than London for international law firms.” See Aled Griffiths, *It’s the Economy, Dummkopf*, AM. LAW., Apr. 2003.

89. A typical quotation from a German lawyer on this transaction was: “It was really a shock to some German firms that [the Daimler-Benz/Chrysler] transaction was handled by . . . an American firm.” John E. Morris, *The British Gambit*, AM. LAW., Nov. 1998.

90. See, e.g., Nick Ferguson, *Merger Fever Grips German Market*, 18 INT’L FIN. L REV. 35, 37 (1999). By 2002, an evaluation of the somewhat larger group of the top twenty German firms showed only six were not part of a U.K., U.S., or worldwide partnership, and three of them (CMS Hasche Sigle, Heuking Kuhn Leur Heussen Wojtek and Gleis Lutz) had formal alliances with U.K. firms. The Lawyer 200, *Germany: The Maus that Roars*, available at [http://www.the-lawyer.co.uk/LawyerNews/top100/editorialpages/overview\\_themaus.asp](http://www.the-lawyer.co.uk/LawyerNews/top100/editorialpages/overview_themaus.asp) (last visited June 25, 2003). Of the three major independents, two operate under best friends agreements with U.K. firms (Hengeler Mueller with Slaughter and May and Norr Stiefenhofer Lutz with Macfarlanes; the former Haarmann Hemmelrath had no such arrangement). *Id.*

TABLE 4

## GERMANY'S LEADING (LARGEST) FIRMS—INTERNATIONAL MERGERS

1999		2000		2001		Foreign Partner
Bruckhaus Westrick Heller Lober	323	Freshfields Bruckhaus Deringer	363	Freshfields Bruckhaus Deringer	446	Freshfields (U.K.)
Oppenhoff & Radler	287	Clifford Chance Punder	391	Clifford Chance Punder	421	Clifford Chance (U.K.)
Punder Volhard Weber & Axster	256	Oppenhoff & Radler Linklaters & Alliance	284	Linklaters Oppenhoff & Radler	396	Linklaters (U.K.)
Wessing & Berenberg- Gossler	205	CMS (Cammeron McKenna) Hasche Sigle Eschenlohr Peltzer	230	Andersen Luther Menold & Aulinger	350	Andersen (Accounting)
Haarmann Hemmelreth & Partner	203	Wessing	213	CMS Hasche Sigle	310	CMS Group (U.K.)
Gaedertz	194	Andersen Luther	201	KPMG Treuhand Beiten Burkhardt	280	KPMG (Accounting)
Boesebeck Droste	181	Gaedertz	195	Lovells Boesebeck Droste	264	Lovells (U.K.)
Feddersen Laule Ewerwahn Scherzberg Finkelnburg Clemm	179	Lovells Boesebeck Droste	195	Wessing & Taylor Joyson Garrett	212	Joyson (U.S.)
Beiten Burkhardt Mittl & Wegener	172	BBLP Beiten Burkhardt Mittl & Wegener	187	Hengeler Mueller	176	(Independent )
Cleiss Lutz Hootz Hirsch	150	White & Case, Feddersen	160	White & Case, Feddersen	173	White & Case (U.S.)

Source: Akira Kawamura, *Bengoshi Seido Henkaku no Sekaiteki na Choryu to WTO* [Global Trends in Changes in the Lawyers' System and the WTO], 53 JIYU TO SEIGI 14, 16 (Nov. 2002) (citing Frankfurter Allgemeine Zeitung, April 27 1999, "A German Legal Journal," February 1, 2001, and "a private source," June 2002).

In the post-merger world, the U.K.-based firms now dominate the German market, as revenue from German operations at three of the Big Four London firms dwarf the revenue of the largest remaining independent German firm (see Table 5). This has led to significant debate in Germany over whether this dominance by the U.K. firms has destroyed traditional German legal culture or whether some creative synthesis of English and German firms is emerging.<sup>91</sup>

TABLE 5  
ELITE AND FIRST-TIER FIRMS IN GERMANY

FIRM	REVENUE (IN EUROS)	REVENUE PER LAWYER (IN EUROS)	NUMBER OF LAWYERS	JUVE REPUTATIONAL RANKING GROUP*
Freshfields Bruckhaus Deringer	293,000,000	530,800	552	1
Clifford Chance	157,000,000	449,900	349	2
Linklater Oppenhoff & Rädler	152,700,000	465,500	328	2
Hengeler Mueller	152,100,000	831,100	183	1
CMS Hasche Sigle	142,200,000	407,500	349	3
Lovells	107,100,000	451,900	237	3
Gleiss Lutz	96,700,000	555,700	174	2
Shearman & Sterling	95,900,000	913,300	105	2
Taylor Wessing	95,400,000	445,800	214	5
Baker & McKenzie	90,200,000	512,500	176	3
*Juve has grouped the top fifty firms in Germany into seven tiers as follows: First Group: two firms, Second Group: four firms, Third Group: five firms, Fourth Group: four firms, Fifth Group: two firms, Sixth Group: thirteen firms, and Seventh Group: twenty firms.				
Sources: Brenda Sandburg, <i>They'll Take 'Meinhattan,' U.S. Firms Don't Always Have an Easy Time in Germany—But They Can't Stay Away</i> , AM. LAW., May 2006, at 196, 202 (citing 2004 data from Juve); GERMAN COMMERCIAL LAW FIRMS 2005: A HANDBOOK FOR INTERNATIONAL CLIENTS, available at <a href="http://www.juve.de/cgi-bin/juve/ihb2005_ranking.cgi?idukap=1">http://www.juve.de/cgi-bin/juve/ihb2005_ranking.cgi?idukap=1</a> .				

91. It should be noted, however, that this cataclysm only affected the elite firms, which at the beginning of 2002 employed a relatively small percentage of Germany's lawyers (see Table 1). The divide in the German legal market between a large number of regional firms that focused on mid-sized clients and a small number of national firms focusing on large corporate clients remained essentially intact.



Following the mergers, significant structural differences remained between the U.K. and German merger partners. The large, international firms sought to appeal to German law school graduates through a combination of reputation<sup>92</sup> and increased compensation.<sup>93</sup> However, the downside also became apparent as the German offices of the U.K.-based firms were forced to make significant structural adjustments, which included a greater emphasis on profitability, office closings, partner de-equitization and firings, and tougher standards for promotion to partner.<sup>94</sup> These adjustments have increased movement in the lateral market and have permitted U.S. firms to enter the German market by attracting German lateral partners in hot new areas like private equity.<sup>95</sup> They have also resulted in senior associates and partners from the U.K.-dominated firms leaving and forming new boutiques.<sup>96</sup> On the other hand, as noted above a few commentators saw a beneficial fusion of English

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92. For example, Freshfields Bruckhaus Deringer claimed that “a recent survey shows that German law school graduates and trainees prefer to work in large law firms because they offer international exposure and better career opportunities.” See Press Release, Freshfields Bruckhaus Deringer, German Law Graduates Prefer Large Firms (Feb. 22, 2002), available at <http://www.freshfields.com/news/dynamic/Pressrelease.asp?newsitem=176> (citing a survey conducted in January 2002 by Berlin Trendence Institute finding that a plurality of students and trainees polled preferred to work at a large firm and that Freshfields was the particular firm most often mentioned).

93. By way of illustration, the managing partner of the Frankfurt office of a U.S. firm was quoted as follows: “We haven’t found hiring too difficult. We pay at the top end of the [Frankfurt] salary scale—and then some.” See Tom Blass, *Making a Mark*, AM. LAW., Apr. 2002, at 132.

94. In overall revenue, the top twenty firms in Germany grossed one billion pounds in 2002, compared with 3.3 billion pounds by the top twenty English firms. See 2002: *The Silver Age*, supra note 67. Structural adjustments have been imposed gradually. In 2002, revenue per lawyer at the German practices of international firms remained below the firmwide levels, e.g., at Freshfields Bruckhaus Deringer (325,000 pounds/attorney in Germany versus 391,000 firmwide) and at Clifford Chance Pundar (294,000 versus 347,000). See *Germany: The Maus that Roars*, supra note 90. The partner/associate ratio at the German practice of Freshfields is 1:1, while firmwide it is 1:4. *Id.* Even the lone first-tier independent firm, Hengeler Mueller, has increased its ratio from its traditional 1:1 to 1.7:1. *Id.*

95. See Heather Smith, *Race to the Top: U.S. Firms Discover a Window of Opportunity in Germany, Thanks to the Private Equity Boom*, AM. LAW., May 2005, at 118. This trend has included lateral partner movement from all of the Big Four London-based firms. *Id.* This includes Freshfields, despite its emphasis on characterizing its merger with its German partner as a merger of equals and on avoiding the imposition of harsh, restructuring measures. *Id.* By contrast, reportedly no partners have been lured away from the private equity practice of Germany’s remaining first-tier independent firm, Hengeler Mueller. *Id.*

96. See Brenda Sandburg, *They’ll Take ‘Meinhattan’ U.S. Firms Don’t Always have an Easy Time in Germany—But They Can’t Stay Away*, AM. LAW. May 2006, at 196, 198.

and German legal cultures rather than any Anglicization of German practice.<sup>97</sup>

This wave of mergers was so sudden and complete that some have likened it more to a wave of hostile acquisitions by U.K. firms than to traditional friendly mergers.<sup>98</sup> Indeed, in most cases the often-quoted pros and cons of merger versus alliance were swept aside by the merger wave. There is little doubt that both the U.K. firms and national German firms were frightened that with a limited number of desirable partners on each side, they might be left empty-handed in a game of musical chairs once the music stopped. In particular, an international merger by a first-tier firm (Pundar) sent a shock through the elite law firm community, resulting in herd behavior by most first-tier firms and a significant number of other elite, national firms.

Were mergers the only possible strategy for German firms? The answer is clearly no, as a number of counterexamples exist. Most prominently, the firm of Hengeler Mueller became the only first-tier German firm to maintain its independence, which places it in the potentially advantageous position of having numerous opportunities to cooperate on projects with foreign firms who are reluctant to use the local office of a rival. Rather than an all-or-nothing choice, there are, in fact, a range of options, which include less formal alliances and best friends referral relationships.<sup>99</sup>

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97. According to this view, the importance of the German market and German lawyers assures that enlightened self-interest (including the fear of losing partners to other firms) will prevent the U.K. firms from running roughshod over their German offices. Proponents point to the case of Freshfields, in which the German merger partner refused Freshfield's initial merger offer and negotiated a better deal in which the German firm's names are included in the Freshfield's name on a worldwide basis and in which all practice groups have joint heads, one of which is a German partner. See GERMAN COMMERCIAL LAW FIRMS 2004: A HAND BOOK FOR INTERNATIONAL CLIENTS, available at [http://www.juve.de/cgi-bin/juve/ihb\\_introtxt.cgi?teil=National%20Review](http://www.juve.de/cgi-bin/juve/ihb_introtxt.cgi?teil=National%20Review). Indeed, the leading German publication on the legal services industry goes so far as to say that the mergers with U.K. firms *saved* German firms. See *id.* The German situation is cited in contrast to that of a country like France, where it is alleged that Anglo-Saxon firms consistently pick off the rising stars—i.e., young partners who want a sophisticated, international practice—to the detriment of the future development of French firms and legal culture. See *id.*

98. See, e.g. Henssler & Terry, *supra* note 85, at 272 (“[T]he German legal profession has been in turmoil since 1998 when Anglo-Saxon law firms started to enter the German market on a large scale. While some would say they behaved like charming grooms, to describe them as acting like a leviathan with a ferocious appetite is probably more appropriate.”).

99. Hengeler Mueller has a non-exclusive network of friends in Europe and the United States that includes Slaughter & May in the United Kingdom and four first-tier firms in the United States. See Sandburg, *supra* note 96. Gleis Lutz has a formal alliance with Herbert Smith in the United Kingdom and Stibbe in Brussels and Amsterdam. See *id.*

In essence, however, most national German firms, although having no prior global ambitions or strategy, suddenly became convinced that they must merge into a large, international law firm to compete on a global, or at least pan-European, basis. A number of factors contributed to this surprising phenomenon, and it is important to emphasize the high profile three-way merger engineered by Clifford Chance with a first-tier German firm. This merger occurred at a time of great anticipated change, due to the creation of the Euro zone and a unified European market, and when there was a particular lack of information about the possible results of such change. Under the circumstances it seemed at least plausible that an international combination might be necessary. The conservatism of lawyers and the fear of being left behind at a time of rapidly changing market conditions may have supplied the necessary impetus.

The changes in the German legal market following the merger wave in the year 2000 seem permanent; only the likelihood of the continued existence of the few remaining significant independent firms remains subject to debate. The largest independent German firm, Haarmann Hemmelrath, split up in 2005 following the departure of one of its name partners to set up a new boutique firm.<sup>100</sup> The other independents seem content for now but might well reassess the necessity of an international merger if there were a new dramatic event, such as a transatlantic merger with a first-tier U.S. firm.<sup>101</sup>

### B. Australia

Like Germany, Australia has a federal system, and law firms were initially restricted to practice in a single state.<sup>102</sup> During the past twenty years, as client businesses became national, law firms

100. The firm, which was started by partners from Peat Marwick in 1987, was a multidisciplinary law and accounting practice, which at its peak in 2002 numbered 350 lawyers in twenty-four offices. See Brenda Sandburg, *German Disunity: Haarmann Hemmelrath, Germany's Largest Independent Firm, Breaks Up, and International Firms Gather the Spoils*, AM. LAW., May 2006, at 206. The immediate reason for the split up seems to relate to restructuring of the partner compensation system in 2004 and 2005, with subsequent lateral moves by disgruntled partners. *Id.* A number of groups ended up with U.S. or U.K. firms. *Id.*

101. Partner Gerhard Wegen of Gleiss Lutz commented, "[If, for example,] Slaughter were to merge with Davis Polk, or Freshfields gets a merger partner with any of the top five or six firms in New York, it would probably make us think again." See Sandburg, *supra* note 96, at 204.

102. See generally Law Council of Australia, National Practice—the move towards a national legal profession, available at <http://www.lawcouncil.asn.au/natpractice/home.html>. The Law Council adopted a Blueprint for the Structure of the Legal Profession in 1994, available at <http://falcon.law.unsw.edu.au/download.html?table=policies&oid=1960506451&index=0>, which has guided the movement away from strict territorial regulation and towards a national legal profession.

also went from a system of affiliation between regional firms in Sydney and Melbourne (the two most significant and profitable legal markets in Australia) to one, in recent years, of merger and the formation of integrated national partnerships. During this process the number of leading Australian firms gradually shrunk from twelve to the current "Big Six" (see Table 6) and became large, national firms with roughly 200 partners and 700-1000 lawyers each.<sup>103</sup>

**TABLE 6**  
**ELITE AND FIRST-TIER FIRMS IN AUSTRALIA**

<b>FIRM</b>	<b>REVENUE PER LAWYER (Global 100 Rank for Profits per Partner) (Unit: Australian Dollar)</b>	<b>REVENUE (Unit: One Million Australian Dollars)</b>	<b>NUMBER OF LAWYERS (Global 100 Rank)</b>
Arnold Bloch Leibler	615,000	40m	65
Baker & McKenzie	548,000	125m	228
Corrs Chambers Westgarth	531,000	200m	377
Clayton Utz*	498,000 (80)	361.4m	726 (47)
Mallesons Stephen Jaques*	474,000 (72)	445m	939 (31)
Gilbert + Tobin	469,000	75m	160
Allens Arthur Robinson*	457,000 (90)	350m	766 (55)
Gadens Lawyers	428,000	125m	292
Henry Davis York	417,000	70m	168
Freehills*	392,000 (85)	417.8m	1067 (42)
Deacons	389,000	173m	445
Minter Ellison*	366,000 (99)	405m	1107 (22)
Blake Dawson Waldron*	340,000 (94)	322m	946 (51)
Phillips Fox	263,000	211m	803
<b>*First-Tier Firms</b>			
Source: <i>The Global 100</i> , AM. LAW., Nov. 2005; Law Firms Revenues Revealed, ASIAN LEGAL BUS., July 2005, available at <a href="http://www.asianlegalonline.com/asia/detail_article.cfm?articleID=3107">http://www.asianlegalonline.com/asia/detail_article.cfm?articleID=3107</a> .			

103. Although significant in terms of the number of lawyers, Australian firms have lower profits than U.S. and U.K. firms. Compare Table 2 and Table 3 with Table 6. The Big Six Australian firms are listed on the AmLaw Global 100. See *The Global 100*, AM. LAW., Nov. 2005, at 117, 123. On the chart for the number of lawyers their rankings range from twenty-two to fifty-five, while on the chart for profits per equity partner their rankings range from seventy-two to ninety-nine. See *The Global 100*, AM. LAW., Nov. 2005, at 117, 123; see also Table 5.

Australian firms faced the usual challenges involved in merging to create national firms, including partner admission and compensation, client conflicts, and cultural differences.<sup>104</sup> Today the Big Six firms are the largest, but not necessarily the most profitable, law firms in Australia.<sup>105</sup> The Big Six do, however, generally monopolize significant corporate transactions for major companies.<sup>106</sup> Although they are collectively referred to in Australia as the top-tier firms, there is considerable debate as to whether the weaker firms among the Big Six truly qualify as first-tier firms.<sup>107</sup>

Australia has an economy and market for legal services that is moderately sized, not growing rapidly, and is mature. It is one of the very few countries where there is a common perception of an oversupply of commercial lawyers. Although mergers to form national firms were justified, as elsewhere, by the need to obtain a critical mass,<sup>108</sup> questions remain whether the Big Six firms have

104. These have been described as “notoriously difficult in mergers across state borders in Australia.” See Lucinda Schmidt, *Brand and Deliver*, at <http://www.brw.com.au/stories/20021212/17410p.aspx> (last visited July 29, 2003). In one of the successful mergers in July 2001, between Allen Allen & Hemsley of Sydney and Arthur Robinson & Heddenwicks of Melbourne, the firms had already had a strategic alliance for seventeen years and operated jointly in Asia. *Id.* By contrast, in November 2001 Middletons Moore & Bevins, a mid-sized federation of a Sydney and Melbourne firm split into two separate firms rather than take the path of integrating their partnerships on a national basis. See, e.g., Lucinda Schmidt, *Strategy: Double Act*, at <http://www.brw.com.au/stories/20020822/15978p.aspx> (last visited July 29, 2003).

105. A group of smaller firms just below the Big Six have equal or greater profitability. The trio of “contenders” in the next tier are Arnold Bloch Leibler, Baker & McKenzie, and Corrs Chambers Westgarth. See *A Vintage Year*, ASIAN LEGAL BUS., July 2006, available at [http://www.asianlegalonline.com/asia/detail\\_article.cfm?articleID=4049](http://www.asianlegalonline.com/asia/detail_article.cfm?articleID=4049). Arnold Bloch Leibler has the highest profitability of any Australian firm as measured by revenue per lawyer, and Baker & McKenzie is also among the highest. *Id.* Phillips Fox was traditionally ranked above these three, but in the last few years revenue is down. See *id.*; see also Table 6.

106. See, e.g. Legal500.com, *Legal Market: Australia* (noting that “[o]f this Big Six, it would be rare to see a major corporate transaction, structured financing or infrastructure project without at least one of them on board”); see also *Law Firm Rankings Revealed*, Lawyers Weekly Magazine, May 6, 2005 (noting that the Big Six firms dominated the twenty-four Practice Area Awards contained in the 2005 Fuji Xerox Australian Law Awards, which were endorsed by the Australian Corporate Lawyers Association).

107. Minter Ellison lost revenue during 2004-2005 due to a restructuring and is said to have suffered from a number of partner departures. See *A Vintage Year*, *supra* note 105. Blake Dawson Waldron similarly suffered partner departures and closed its London office. *Id.* Some commentators perceive a split among the Big Six between the top three firms and the next group of three firms. *Id.*

108. See Lauren Scott, *Too Big to Profit?*, ASIAN LEGAL BUS., March 2004, available at [http://www.asianlegalonline.com/asia/detail\\_article.cfm?articleID=1756](http://www.asianlegalonline.com/asia/detail_article.cfm?articleID=1756) (quoting Philip Clark, managing partner of Minter Ellison, as stating that “[u]ntil you get critical mass, you don’t have the resources or the brand or the credibility to play in the big league”).

become too large for the local market.<sup>109</sup> They are regularly cited as having far lower billing rates than U.S. and U.K. firms, with correspondingly low profitability.<sup>110</sup> Foreign firms have historically shown little interest in establishing substantial practices in Australia.<sup>111</sup>

Following the emphasis on rapid growth and mergers during the 1990s, over the past several years Australian firms have begun to place a greater emphasis on profitability over domestic market share and revenue expansion.<sup>112</sup> This new emphasis on profitability has been accompanied by many of the changes in law firms seen in other jurisdictions: an increase in leverage (i.e., more associates per partner); a longer and more uncertain partnership track for associates; an emphasis on productivity (both in terms of pressure to increase billable hours and to provide compensation based on productivity); increased competition for quality associates; firm

109. The total number of lawyers does not seem excessive compared to the population or GDP. However, an unusually large percentage of the lawyers in Australia do corporate work at elite firms, which may account for the perceived oversupply of commercial lawyers. See Table 1. The Big Six Australian firms are significantly larger, in relation to either population or the number of lawyers, than the largest U.S./U.K. firms; some argue that they are too large for the Australian market. In the words of the managing partner at Minter Ellison, "you've got six monster firms crawling over a market that's half the size of California." Scott, *supra* note 108. The former chief executive partner at another Big Six firm has been cited as suggesting that a critical mass in Australia might be 100 partners, rather than the 200 or so partners of the Big Six firms. See Bernard Kellerman, *Value, Not Cost, is the Issue*, CFO MAG. (citing Tony D'Aloisio of Mallesons), available at <http://www.cfoweb.com.au/freearicle.aspx?relId=9669> (last visited Sept. 17, 2005).

110. This prompted a justice of Australia's high court to note in a speech that:

In the global economy, Australia's big legal firms are, in any case, small beer. The fees they charge are said to be on average a quarter or a third of the levels charged in Britain and the United States. Perhaps this is why some of the big overseas firms will not amalgamate with our local big league.

See The Honorable Justice Michael Kirby AC CMG, Address at the Australian Law Awards Annual Dinner (Mar. 7, 2002) (transcript available at [http://www.hcourt.gov.au/speeches/kirbyj/kirbyj\\_award.htm](http://www.hcourt.gov.au/speeches/kirbyj/kirbyj_award.htm)).

111. Baker & McKenzie is the major exception. It is one of the three firms generally ranked just below the Big Six and is the only foreign firm that arguably competes directly with the major Australian firms. See *supra* note 105 and accompanying text. In addition, DLA Piper recently entered into a formal alliance with an Australian firm. See *id.*

112. See, e.g., ALB 30—Critical Mass, ASIAN LEGAL BUS., March 2006, available at [http://www.asianlegalonline.com/asia/detail\\_article.cfm?articleID=3704](http://www.asianlegalonline.com/asia/detail_article.cfm?articleID=3704) (noting that large Australian firms have stopped growing and instead have concentrated on reducing the number of lawyers to achieve greater profitability). Apparently this effort has resulted in some success, as the gap between average partner income at top-tier firms and mid-tier firms has been increasing. See Mahlab Recruitment, Private Practice Australia and International Survey 2006, at 14, available at <http://www.mahlab.com.au/index.cfm?pageID=43> (finding that the average partner compensation in Sydney at a top-tier firm is \$1,015,000 and \$643,000 in Australian dollars at a mid-tier firm).

restructurings including easing out of partners; and an active lateral market (including not only associates but also partners at Big Six firms).<sup>113</sup>

With limited potential for rapid growth in the competitive domestic market, the largest Australian firms have had an ongoing interest in the potential for expansion into Asia. Although government policy has encouraged such international expansion,<sup>114</sup> there have been periods of both advance and retreat over the past twenty years. The efforts and strategies of the Big Six firms have varied, and the results have been mixed. The China boom has perhaps accentuated the differences. Two of the Big Six have opened substantial offices in the China region, one by way of merger.<sup>115</sup> The other four Big Six firms have displayed greater caution, as the increasingly crowded China market poses a challenge to profitability for many firms. In any event, given the size of the large Australian

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113. See generally *A Vintage Year*, *supra* note 105. To give one example, the typical partnership track is now twelve years, compared to eight to ten years a few years ago. See Mahlab Recruitment Survey 2006, *supra* note 112, at 14. Although the total number of partners at most law firms is not growing, the “churn” rate of partner departures is a relatively high 6.7% in firms surveyed. See *id.* at 2 (citing a survey by *The Australian* newspaper).

114. Over the past few decades Australia has tied its future to Asia, being, for example, one of the key players in establishing the Asia-Pacific Economic Cooperation Treaty (APEC) in the 1990s. The government also established a public-private committee in 1990 that advises and reports on “Australia’s international performance in legal and related services.” For an overview of the committee (now advisory council) and its activities, see International Legal Services Home Page, <http://www.ag.gov.au/agd/www/ilsHome.nsf>. In 1999, the advisory council formulated a “legal services export development strategy,” which was updated in 2003. For a discussion of this strategy, see International Legal Services Advisory Council, Australian Legal Services Export Development Strategy 2003-2006, available at [http://www.ag.gov.au/www/agd/agd.nsf/Page/Committeesandcouncils\\_Councils\\_InternationalLegalServicesAdvisoryCouncil\(ILSAC\)\\_InternationalLegalServicesAdvisoryCouncil](http://www.ag.gov.au/www/agd/agd.nsf/Page/Committeesandcouncils_Councils_InternationalLegalServicesAdvisoryCouncil(ILSAC)_InternationalLegalServicesAdvisoryCouncil).

115. Mallesons Stephens Jacques changed its go-it-alone policy in 2004 with a merger with the Hong Kong firm of Kwok & Yi, making it one of the ten largest firms in Hong Kong. See, e.g., Malleeson’s News: Mallesons Stephen Jaques and Kwok & Yih Merger Completed, <http://www.mallesons.com/news/articles/7556779w.htm> (last visited Apr. 23, 2007). Allens Arthur Robinson has also opened two offices in China and others throughout Asia. See *The Great Expansion Debate*, ASIAN LEGAL BUS., Nov. 2005, available at [http://www.asianlegalonline.com/asia/detail\\_article.cfm?articleID=3418](http://www.asianlegalonline.com/asia/detail_article.cfm?articleID=3418). Other firms emphasize, however, that “it’s simply not a matter of numbers in a market like that. . . . It’s all about doing quality work and thereby attracting and maintaining quality lawyers.” *Id.* (quoting Sam Farrands, the managing partner of the Hong Kong office of Minter Ellison). Malleeson’s has a stated intention to compete directly with the English magic circle firms in Hong Kong for the most profitable (highest value-added) projects, such as capital markets work; others are skeptical that Mallesons or any Australian firm can successfully do so. *Id.*

firms, none of them derives a large portion of their revenue from overseas operations.<sup>116</sup>

Unlike Germany, there were no international mergers involving Australian firms, despite the stated interest of major Australian firms in merging with large U.K. firms.<sup>117</sup> There is no Asian equivalent to the unified market in Europe that creates expectations of substantial cross-border work. The Australian market for legal services is mature, highly competitive, and may not be sufficiently profitable. The major Australian firms are large, and the number of partners could not be as easily absorbed by a U.K. firm as, for example, a leading German firm.

Nevertheless, Australian firms appeared to be doing well in the late 1990s, with good domestic growth and the potential to act as a springboard for significant expansion into Asia. In 1999, Clifford Chance was reportedly contemplating a three-way merger with Pindar of Germany and a major Australian firm; when it was able to negotiate a merger with Rogers & Wells in the United States, a more attractive market, it shelved its plans regarding Australia.<sup>118</sup> As Asia, particularly China, has become an attractive market in the last few years, major U.S. and U.K. firms have devised and implemented their own Asian strategies independent of Australian firms.<sup>119</sup>

Hopes of new relationships with foreign firms were rekindled recently as a result of a new alliance in June 2006 between the internationally expansionist U.S. firm DLA Piper<sup>120</sup> and the Australian firm Phillips Fox. This is reportedly the first exclusive alliance between an Australian firm and a foreign firm,<sup>121</sup> and it is too early to evaluate the impact of this alliance on other Australian firms. As the alliance is not a formal merger and, more importantly,

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116. One of the more aggressive Big Six firms in Asia, Allens Arthur Robinson, claims that 10% of its revenue is related to Asia. *The Great Expansion Debate*, *supra* note 115.

117. See, e.g. Douglas McCollam, *The Global 100 Leaders and Laggards, Outposts and Outlooks: A Region-by-Region Examination of the Worldwide Legal Market Asia and the Pacific Rim: At a Glance Australia*, AM. LAW. Nov. 2001 (quoting the managing partner of one of Australia's Big Six firms, Minter Ellison, as stating that "Merger is on our agenda but not theirs.").

118. See John E. Morris, *The New World Order: Clifford Chance and Rogers & Wells Are about to Pull Off the First Large-Scale Transatlantic Merger. Did the Eat-What-You-Kill Americans Ever Come to Terms with the Lockstep Brits? And, More Importantly, What Will It Mean for the Competition?*, AM. LAW., Aug. 1999, at 92.

119. See, e.g., Elizabeth Amon, *Bar Talk, China's Next Wave*, AM. LAW., June 2004 (noting that by mid-2004 there were 160 law firms in China, thirty of which were U.S. firms); Press Release, Hogan & Hartson L.L.P. Expands Practice in Asia; Firm to Open Office in China (July 23, 2002), available at <http://www.prnewswire.co.uk/cgi/news/release?id=88506>.

120. See *supra* note 1 and accompanying text.

121. See, e.g., *Our Global Alliance*, <http://www.phillipsfox.com/alliance/Alliance.asp> (last visited Apr. 23, 2007). The website reports that Phillips Fox has become a member of the DLA Piper Group and will change its name to DLA Phillips Fox. *Id.*



neither firm is a first-tier firm, it would be surprising if this alliance provoked a strong competitive reaction from either the global U.K. firms or the Australian Big Six firms. It also remains to be seen if operating within the DLA Piper group will accelerate change at Phillips Fox and ultimately make it more competitive.<sup>122</sup>

## V. THE EMERGENCE OF ELITE LAW FIRMS AND MERGERS IN JAPAN

Japan is the most interesting and comprehensive case study in this Article because of recent events that challenge widespread skepticism concerning both the role of lawyers in significant business matters in Japan generally and the permitted activities of foreign lawyers in particular. This skepticism stems both from objective factors, such as the small number of Japanese lawyers<sup>123</sup> and a traditional lack of large corporate law firms, and also from popular views of Japan, which have long emphasized the importance of cultural values and the unimportance, if not active dislike, of law and lawyers in Japanese society.<sup>124</sup> However, growth in the demand for corporate legal services, coupled with growth in the supply of lawyers and the new attractiveness of corporate law firms for young lawyers, has led to the development of large, elite firms and Japan's own mini-wave of law firm mergers over the past few years. The issues discussed with respect to law firms in other countries are highly relevant to Japanese law firms today.

For much of the postwar era, both the image and reality of law practice in Japan centered on lawyers providing general legal services in small law offices with a focus on litigation.<sup>125</sup> However, from the

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122. As noted above, Australian firms generally have shifted emphasis from growth to profitability over the past few years; some commentators think this process has been insufficient and see potential for an efficient foreign firm to effect a more radical restructuring in the Australian market. See *ALB 30—Critical Mass*, *supra* note 112. DLA Piper has reportedly been successful in other low-margin markets (such as Scotland) by having a low number of equity partners and a strong performance-oriented (“eat what you kill”) compensation system. See *id.* The initial impact on Phillips Fox was seemingly negative. It reportedly lost fifteen of the twenty-one partners in its Perth office as it integrated that office into the national partnership in preparation for its alliance with DLA Piper. See *A Vintage Year*, *supra* note 105.

123. The number of lawyers in Japan, as of year-end 2004, is 21,174. See Bengoshi Hakusho 2005 Nenpan [Attorney White Paper 2005 Edition] 78 (Nihon Bengoshi Rengokai Ed., 2005) 78 [hereafter White Paper]. Although the absolute number of lawyers (*bengoshi*) is small, comparisons with other countries are not so simple. Japan has other categories of legal service providers and a large number of undergraduate law majors, some of whom provide legal services in-house for corporations and other organizations. For a comparative discussion of the various categories of legal professionals in Japan, see Masanobu Kato, *The Role of Law and Lawyers in Japan and the United States*, 1987 B.Y.U. L. REV. 627 (1987).

124. See generally Kato, *supra* note 123.

125. *Id.* at 649-51.

early postwar years there were also a limited number of corporate law firms in Tokyo, initially headed by American lawyers,<sup>126</sup> which focused on international corporate matters. By the 1960s, Japanese lawyers trained at these firms had formed their own corporate law firms. Much like their English counterparts based in London, some of these Tokyo-based corporate firms eventually developed into elite national law firms.<sup>127</sup>

Corporate law firm growth, which progressed slowly but steadily in the 1980s and 1990s, was soon to increase. One of the important conditions permitting greater growth was the gradual development of a substantial domestic market for corporate legal services beginning in the 1990s. During Japan's "lost decade" following the collapse of the bubble economy, a host of factors, such as financial deregulation,<sup>128</sup> administrative reform, restructuring of industry, shareholder derivative litigation,<sup>129</sup> the rising importance of

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126. During the occupation years a number of U.S. citizens were licensed under Article 7 of Japan's attorney law as quasi-members of the Japanese bar (*jun-kai-in*) and were permitted to practice the law of their home country. See Bengoshi Ho [Practicing Attorney Law] (Law No. 205 of 1949); see, e.g., John O. Haley, *Redefining the Scope of Practice Under Japan's New Regime for Regulating Foreign Lawyers*, 21 LAW IN JAPAN 18, 21 (1988). Article 7 was abolished in 1955; however, an estimated half of the sixty-eight admitted foreign lawyers practiced law and were grandfathered and continued to practice law. *Id.* at 21-22. No new foreign attorneys were registered in Japan until 1987, following the enactment of a new law. *Id.* at 18.

127. Japan is a unitary rather than a federal system, and business and government remain centered in Tokyo. In addition, the heavy concentration of lawyers in Tokyo (and, to a lesser extent, Osaka) aided the development of elite national firms. In 2004, lawyers in Tokyo comprised 48.47% of all lawyers in Japan, while Tokyo's population was 9.69% of the total Japanese population. White Paper, *supra* note 123, at 77. Thus in Tokyo, there was one lawyer for each 1,206 inhabitants, as opposed to the national average of one lawyer per 6,030 inhabitants. See *id.* The potential for Japanese lawyers in these leading urban areas to expand their role beyond traditional litigation-oriented activities was recognized by some at an early stage. See Takao Tanase, *The Urbanization of Lawyers and its Functional Significance: Expansion in the Range of Work Activities and Change in Social Role*, 13 LAW IN JAPAN 20 (Bruce E. Aronson trans., 1980) (arguing that the high concentration of lawyers in the metropolises of Tokyo and Osaka was due to the attractive prospect of expanding their traditional range of work activities and social role).

128. Whole new fields, such as financial services regulation and advice on on-site inspections by government examiners, became new sources of demand from both Japanese and foreign clients. In the last few years Japanese clients have become active in new financial products such as securitizations and domestic project finance.

129. Shareholder suits highlighted the additional need to both avoid potential liability for bad business decisions and to adopt more formal rule-based compliance and other policies. The most dramatic case was a court decision in 2000 related to the well-known Daiwa Bank scandal, in which a district court awarded \$775 million in damages to the plaintiffs for directors' breaches of fiduciary duties. *Nishimura v. Abekawa* (Daiwa Bank Case), 1721 Hanrei Jiho 3 (Osaka Dist. Ct., Sept. 20, 2000). For excerpts of the decision in English, see Bruce E. Aronson, *Learning From Comparative Law in Teaching U.S. Corporate Law: Director's Liability in Japan and the U.S.*, 22 PENN ST. INT'L L. REV. 213, 227-231 (2003). For an analysis of the decision, see Bruce E. Aronson, *Reconsidering the Importance of Law in Japanese Corporate Governance:*

intellectual property, and an increase in foreign direct investment,<sup>130</sup> combined to highlight the importance of legal services both in controlling business risks and exploiting new business opportunities. These new, significant corporate matters meant that Japanese corporate law firms increasingly needed to provide greater expertise and sizable teams of attorneys.

As the demand for corporate legal services grew, the supply of lawyers became a more important issue.<sup>131</sup> Industry challenged the traditional constraints on the number of lawyers<sup>132</sup> with calls for more lawyers and greater efficiency in the legal system. This resulted in a significant process of legal reform beginning in 1999.<sup>133</sup> A doubling of the attorney population was targeted for 2018,<sup>134</sup>

*Evidence from the Daiwa Bank Shareholder Derivative Case*, 36 CORNELL INT'L L.J. 11 (2003). For a general discussion of shareholder suits in Japan, see Mark D. West, *Why Shareholders Sue: The Evidence from Japan*, 30 J. LEGAL STUD. 351 (2001).

130. Demand for legal services received a boost when a wave of foreign direct investment began in Japan around 1997, particularly in the heretofore off-limits financial services area. When U.S. companies such as GE Capital made an acquisition they naturally expected a significant team of Japanese lawyers with appropriate specializations to perform due diligence. The elite Japanese firms scrambled to meet this demand.

131. One view holds that the shortage of lawyers is "the most fundamental problem" facing Japanese law firms in light of the recent rise in demand for business lawyers. See Yasuharu Nagashima & E. Anthony Zaloom, *The Rise of the Large Business Law Firm and its Prospects for the Future*, in LAW IN JAPAN: A TURNING POINT (DANIEL H. FOOTE ed., forthcoming).

132. The small number of lawyers in Japan has been due primarily to numerical restraints on the creation of new attorneys. See Edward I. Chen, *The Legal Training and Research Institute of Japan*, 22 U. TOL. L. REV. 975 (1991) (describing the Legal Training and Research Institute of Japan). After graduating with a law major, prospective lawyers had to pass an entrance exam (i.e., bar exam) to gain admittance to the government's Legal Research and Training Institute (the Institute); completion of the Institute's two-year course was the sole path to becoming a lawyer, judge, or prosecutor. *Id.* As the number of trainees admitted to the Institute was predetermined at a low level (about 500 per year circa 1990), the resulting pass rate for entrance to the Institute was around 2-3%. *Id.* at 980-81. In the mid-1990s big business groups began to demand an end to governmental "administrative guidance" and an increase in both the role of law (i.e., transparent legal rules) and the number of lawyers. See, e.g., Keidanren, Request for Deregulation/Basic Philosophy, Oct. 28, 1996, available in English at [www.keidanren.or.jp/english/policy/pol054/basic.html](http://www.keidanren.or.jp/english/policy/pol054/basic.html) (last visited June 27, 2007) (Japan's leading business organization publicly calling for "eliminating administrative guidance as much as possible" and for the establishment of rule-making procedures which permit public participation).

133. A special legal reform council was created in the Cabinet in 1999 and issued its final report in 2001. See Recommendations of the Justice System Reform Council—For a Justice System to Support Japan in the 21st Century, June 12, 2001, available at <http://www.kantei.go.jp/foreign/judiciary/2001/0612report.html>.

134. *Id.* at ch. III, pt. 1-1. The report establishes a goal for the total number of legal professionals (i.e., lawyers, judges, and prosecutors) to reach 50,000 by 2018. *Id.*

together with the introduction of new U.S.-style law schools to train these legal professionals.<sup>135</sup>

The first law firm merger between elite firms, announced in 1999 and completed in 2000, created the first Japanese firm with 100 lawyers and ushered in a new era of rapid growth by corporate law firms.<sup>136</sup> Thereafter, large firm growth accelerated rapidly, primarily through the hiring of newly minted attorneys.<sup>137</sup> The largest firms doubled in size from 2000 to 2005 and now number around 200 attorneys (see Table 7). Among the nine or so elite firms, the three longstanding first-tier firms were joined by Mori Sogo in the 1990s and are now commonly referred to as the Big Four.<sup>138</sup> The Big Four typically appear on both sides of major transactions.

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135. See Koichiro Fujikura, *Reform of Legal Education in Japan: the Creation of Law Schools Without a Professional Sense of Mission*, 75 TUL. L. REV. 941 (2001) (emphasizing the shortcomings of Japan's new law schools); see also James R. Maxeiner & Keiichi Yamanaka, *The New Japanese Law Schools: Putting the Professional into Legal Education*, 13 PAC. RIM. L. & POL'Y J. 303, 310 (2004); Setsuo Miyazawa, *Education and Training of Lawyers in Japan—A Critical Analysis*, 43 S. TEX. L. REV. 491, 493 (2002).

136. Misasha Suzuki, *The Protectionist Bar Against Foreign Lawyers in Japan, China, and Korea: Domestic Control in the Face of Internationalization*, 16 COLUM. J. ASIAN L. 385, 395 (2003).

137. First-year associate classes at large firms expanded significantly, as a typical first-year class at one of the four first-tier firms has grown from around five to seven attorneys a decade ago to some thirty today. Interviews with the Author and Japanese Attorneys; see also *Zadankai*, infra note 162, at 39 (speaker: Kosugi) (stating that classes of new associates “under ten” continued “for a long time,” but that recent classes were in the “20s and 30s”).

138. Mori Sogo's rise into the first tier was significant in that it was the leader in domestic corporate law, unlike the other first-tier firms, which had focused on transnational corporate transactions. Interviews with the Author and Japanese Attorneys; see also *Zadankai*, infra note 162, at 39 (speaker: Ishiguro). The domestic corporate market has become significant, and now none of the Big Four firms think of themselves as international corporate specialists. In the last few years, Japan's leading business daily, Nihon Keizai Shinbun, has consistently referred to the first-tier firms as the “Big Five,” including the fifth-largest firm, Asahi Koma. See Table 7); see, e.g., *Futto Homu Bijinesu (Jo): M&A Saisei Kage de Enshutsu [Rising Legal Business (Part 1): Production Due to M&A Restructuring]*, NIHON KEIZAI SHINBUN, July 14, 2005 (containing a table of the Big Five Japanese Law Firms”). However, that firm recently entered into a merger with Nishimura & Partners (see Table 8), and as a result there is no longer any disagreement that the leading firms are the Big Four.

**TABLE 7**  
**ELITE (LARGEST) LAW FIRMS IN JAPAN**  
**(BY NUMBER OF ATTORNEYS)**

1985	1999	2002	2005
26	Nishimura & Partners (74)	Nagashima Ohno & Tsunematsu (157)	Mori Hamada Matsumoto (198)
25	Nagashima & Ohno (69)	Mori Hamada Matsumoto (149)	Nagashima Ohno & Tsunematsu (197)
23	Anderson & Mori (58)	Nishimura & Partners (130)	Nishimura & Partners (183)
20	Mori Sogo (58)	Anderson Mori (116)	Anderson Mori Tomotsune (179)
20	Asahi (54)	Asahi Koma (108)	Asahi Koma (140)
20	Mitsui Yasuda (43)	Mitsui Yasuda (71)	TMI (87)
17	TMI (34)	TMI (57)	Tokyo Aoyama Aoki (68)
17	Ohebashi (30)	Tokyo Aoyama Aoki (56)	Ohebashi (64)
16	Matsuo Sogo (29)	City-Yuwa (48)	City-Yuwa (64)
16	Iwata (27)		
	Tokyo Aoyama (26)		
	Hamada & Matsumoto (25)		
	Tsunematsau, Yanase & Sekine (24)		
Sources: 39 Jiyu To Seigi, No. 13, at 61 (1988); 21 International Lawyers' Newsletter, No. 4 (July/Aug. 1999); Japan Federation of Bar Associations, unpublished survey (2002) (on file with author); Horitsu Jimusho, Jinyo wo Zokyo [Law Firms, Build up Their Ranks], NIHON KEIZAI SHINBUN, Feb. 25, 2005, at 1.			

The first merger was both a shock and a significant wake-up call to the legal services industry. It destroyed the common view that there might never be a Japanese law firm with several hundred lawyers.<sup>139</sup> On one level, the merger between the leading Big Four

139. Firm division, rather than merger, had been the rule in the past. The traditional small Japanese law office was often just a cost-sharing arrangement, with no allocation of income among lawyers. For some internationally oriented firms in the 1980s, the model was still a "boss" and his followers, with the name partner or partners supplying all of the firm's equity capital while other "partners" were on salary. Such a structure not only limited a firm's capital base, it also encouraged a tendency for firms to split as soon as an attorney developed a sufficient client base to become a "boss" at his own firm. This also occurred among the firms which ultimately became the Big Four firms. In fact, in the 1980s attorneys spoke of a "rule of twenty" which purportedly described the upper limit of law firm size. This history and attitude colored the reaction to the first major merger among Japanese law firms. Prior to the

firm Nagashima & Ohno and the smaller, elite, finance-oriented firm Tsunematsu, Yanase & Sekine could be explained simply as Nagashima & Ohno wishing to expand from its general corporate strength into the rapidly growing area of financial services. However, the merger also represented a new challenge by a first-tier firm to other leading firms in Japan.

The competitive strategy of Nagashima & Ohno implied by the merger shook competitor firms. For the most part, the reasons given for the merger were similar to those provided everywhere for law firm mergers: to meet client demands for greater size, expertise, and one-stop shopping for large, complex matters with time limitations.<sup>140</sup> However, toward the end of an influential article in a legal publication,<sup>141</sup> the founding partner of the firm, Yasuharu Nagashima, provided some additional reasons for the merger. He cited the example of the Korean law firm Kim & Chang, which was double the size of its nearest competitor among the Big Four law firms in the Korean legal market.<sup>142</sup> This raised the possibility that Nagashima & Ohno might attempt to use the first-mover advantage of its merger to clearly dominate the Big Four firms in Tokyo rather than being the first among relative equals.

Within a few years, two other Big Four rivals and the fifth largest firm similarly had acquired smaller firms with well-known specialties, and the remaining Big Four firm, Anderson Mori, undertook its own merger in 2005 (see Table 8). More importantly,

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merger announcement, the prevailing view in Japan was that it would be "quite difficult to expect the creation of a law firm of several hundred lawyers as seen in Europe and the U.S." See Shoichiro Niwayama & Kazuhiko Yamagishi, *Nihon in okeru Kyodai Horitsu Jimusho no Kanosei* [The Possibility of Large-scale Law Offices in Japan] 49 *JYU TO SEIGI* 34, 40 (Nov. 1998). In 1998, the biggest law firm in Japan was sixty-three lawyers, and adding lawyers to account for a 10% annual increase in business would lead to a firm of 170 lawyers in ten years. In addition, the supply constraint on the number of new attorneys meant that it would be difficult for one firm to grow at a substantially larger rate than the overall increase in the attorney population. *Id.* This popular analysis did not give any consideration to the possibility of a merger between elite firms and most likely underestimated the increase in both the demand for corporate legal services and the supply of attorneys, as well as the increasing attraction of elite corporate firms for new lawyers.

140. There is little direct evidence that clients truly demanded larger law firms in order to service their legal needs. There is, however, anecdotal evidence that lawyers feared losing client business if they fell behind other firms. See, e.g., *infra* note 141. On a related matter, there is little evidence that large law firms in Japan have a clear view of an efficient or "appropriate" size for corporate law firms.

141. See Yasuharu Nagashima, *Nihon no Roo Faamu no Gappei to Diakiboka ni tsuite* [Concerning the Merger and Large-scale Growth of Japanese Law Firms], 50 *JYU TO SEIGI* 14 (1999).

142. *Id.* at 24. In explaining that the first law firm in Japan with over 100 lawyers was not truly a large firm, Mr. Nagashima noted that even in Korea, Kim and Chang had 150 lawyers. *Id.* Taking into account that Korea's population is roughly one-third that of Japan, even to match Korea's largest firm on a per capita basis, a Tokyo firm would require some 450 lawyers. *Id.*

the stakes were now raised and competition intensified. In this new environment, mid-sized firms (second-tier firms of ten to thirty lawyers) in Tokyo faced new concerns about maintaining a stable business, as they feared losing work from even long-established clients. These firms also lost good associates to elite Japanese firms and foreign joint venture firms and began to encounter difficulty in attracting the best new lawyers.<sup>143</sup> Within a few years several of the mid-sized firms dissolved, which was a new phenomenon in the Japanese legal market.<sup>144</sup> In one case, two mid-sized firms merged with the intention of creating a firm that could compete more effectively with larger rivals.<sup>145</sup>

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143. In one typical example, the founding partner of an internationally oriented and stable mid-sized corporate firm with some fifteen lawyers stated in a conversation in the fall of 1999 (following the announcement of the Nagashima & Ohno merger) that he had no interest in growing his firm and felt no need to do so. He explained that nearly all of his client relationships were longstanding ones of twenty or thirty years and expressed confidence in his firm's ability to continue on its traditional course. In a subsequent meeting with the same partner less than two years later, he had changed his mind. He complained that clients paid too much attention to law firm size and merger announcements and stated that he now intended to substantially increase the size of his firm by hiring new attorneys.

144. See Table 8.

145. As of February 1, 2003, the Law Department of Tokyo City Law & Tax Partners merged with Yuwa Partners to form City-Yuwa Partners. See *id.*

**TABLE 8**  
**LAW FIRM MERGERS IN JAPAN**

Effective Date	Merger Partners	No. of Lawyers	Specialty of Smaller Firm
01-01-2000	Nagashima & Ohno	69	Finance
	Tsunematsu, Yanase & Sekine	24	
05-01-2001	Tokyo Aoyama/Baker	42	Securities
	McKenzie Aoki & Partners	16	
10-01-2002	Asahi Law Offices	77	International & Corporate
	Komatsu, Koma & Nishikawa	17	
01-01-2003	Mori Sogo	92	Securities
	Hamada & Matsumoto	42	
01-01-2003	Tokyo City	27	Real Estate International & Corporate
	Yuwa Partners	20	
01-01-2004	Nishimura & Partners	137	Bankruptcy
	Tokiwa Sogo	14	
01-01-2005	Anderson Mori	134	Securities
	Tomotsune & Kimura	23	
04-01-2005	Linklaters	30	Finance
	Group from Mitsui Yasuda	30	
07-01-2005	Mori Hamada & Matsumoto	191	Intellectual Property
	Max Law Offices	13	
07-01-2007	Nishimura & Partners	234	
	Asahi Law Office (International Division)	84	

Source: Firm announcements/websites. See Anderson, Mori & Tomotsune, <http://www.andersonmoritomotsune.com/en/> (last visited March 25, 2007); Asahi Koma Law Offices, <http://www.alo.jp/english/> (last visited March 25, 2007); Baker & McKenzie GJBJ Tokyo Aoyama Aoki Law Office, <https://www.taalo-bakernet.com/e/top.html> (last visited March 25, 2007); City-Yuwa Partners, <http://www.city-yuwa.com/en/> (last visited March 25, 2007); Linklaters, [www.linklaters.com](http://www.linklaters.com) (last visited March 25, 2007); Mori Hamada & Matsumoto, [http://www.mhmjapan.com/home\\_en/](http://www.mhmjapan.com/home_en/) (last visited March 25, 2007); Nagashima, Ohno & Tsunematsu, <http://www.noandt.com/english/index.html> (last visited March 25, 2007); Nishimura & Partners, <http://www.jurists.co.jp/en/index.html> (last visited March 25, 2007); Nishimura & Partners, <http://www.jurists.co.jp/en/topic/2007/t003.shtml> (last visited June 4, 2007).

The unexpected and continuing rapid growth of large corporate law firms from the year 2000 was due to a number of factors. In addition to the steadily increasing demand for corporate legal services, there was a one-time boost to the number of new attorneys in the year 2000 and a gradually increasing supply of attorneys



thereafter.<sup>146</sup> Another significant factor was the growing recognition of both the importance of law and lawyers generally and the rising popularity of large corporate law firms in particular.<sup>147</sup> Increasing competition among firms to recruit highly qualified attorneys<sup>148</sup>

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146. The number of Institute graduates per class had already doubled from about 500 in 1990 to 1,000 in the year 2000. Recommendations of the Justice System Reform Council, *supra* note 133, at ch. III, pt. 1-1. However, the number who chose to become attorneys, rather than judges or prosecutors, was relatively steady during the period 1995-1999 and averaged in the low 400s per year. See White Paper, *supra* note 123, at 69. As part of the legal reform program, the length of the Institute training program was shortened from two years to one year, in anticipation of the new law schools providing more of the practical training component of legal education. *Id.* As a result, two Institute classes graduated in the same year (2000). *Id.* A somewhat greater percentage of Institute graduates chose to become lawyers than in the recent past, with the number of new lawyers in the year 2000 jumping to over 1,100. *Id.* This occurred at a time when demand for corporate legal services was increasing, and the leading corporate law firms were achieving a higher profile, as exemplified by the first merger in 2000. The large firms stepped up their recruitment efforts, inviting large numbers of Institute trainees for recruiting visits at an earlier stage than in the past. After the year 2000, the number of Institute graduates again increased from 1,000 to 1,500 in 2006. The number of new lawyers increased to roughly 600 in 2001-2002, 700 in 2003, and over 900 in 2004. *Id.* at 69. The legal reform plan calls for another doubling of the number of Institute trainees from the current 1,500 to 3,000 by the year 2010. See Recommendations of the Justice System Reform Council Report, *supra* note 133, at ch. III, pt.1-1.

147. The increasing importance of lawyers could be measured in a number of ways. For a study of the increasing popularity of the bar exam compared with the elite public servants' exam, see Curtis J. Milhaupt & Mark D. West, *Law's Dominion and the Market for Legal Elites in Japan*, 34 LAW & POL'Y INT'L BUS. 451 (2003) (discussing the increasing popularity of the bar exam compared with the elite public servant's exam).

Law firms have also received increasing media exposure over the last few years, as Japan's leading business daily, *Nihon Keizai Shinbun*, created a new full-time beat reporter for legal issues. Similarly, lawyers have appeared more regularly on popular television shows and a new legal press, exemplified by a new monthly magazine *The Lawyer*, has begun to appear. Although there are no regular ranking tables of law firms, much of the media exposure focused on the large, elite firms, particularly the Big Four firms. Young lawyers may have come to view the representation of large corporations in an increasingly positive light as a method of promoting the rule of law and contributing to Japan's recovery from its malaise of the 1990s. A number of anecdotal reports indicate that positions with the leading corporate law firms have become the most attractive career option for top Institute graduates. As in most countries, only a relatively small percentage of lawyers work at elite law firms, see Table 1, and even a modest increase in that percentage would presumably be sufficient to increase the growth rate. That appears to be happening in Japan. Comparing percentages between year-end 2001 and year-end 2004, attorneys working at the firms with over 100 lawyers increased from 1.3% to 4.15% of the total attorney population, and for firms with over fifty lawyers the percentage increased from 2.3% to 5.15%. See Bengoshi Hakusho 2002 Nenpan [Attorney White Paper 2002 Edition] 41 (Nihon Bengoshi Rengokai ed., 2002); White Paper, *supra* note 123, at 91.

148. For recruiting efforts, see *supra* note 137. As noted, all new Japanese lawyers, who traditionally had to pass through a hellish exam process with a 2-3% pass rate, would presumably make capable attorneys. See *supra* note 132 (describing the exam process). Nevertheless, firms complain about declining attorney quality and have competed vigorously to find the top candidates. As student grades at the Institute are

further raised the profile of the top firms as a group among new lawyers. Law firm mergers added to the base size of firms, thus increasing the size of their new attorney classes, and also aided in recruiting top talent.<sup>149</sup> The internal structure of Japanese firms also evolved along with their size, as a number of the top firms developed a structure similar to a partnership, which enabled them to take advantage of opportunities for relatively rapid growth in recent years.<sup>150</sup> Lateral hiring, although increasing in Japan, has not been a significant factor in the rapid growth of elite firms.<sup>151</sup>

The activities and potential role of foreign law firms has also been an important question in Japan, as it is the only country

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confidential, top candidates are ranked by the prestige of their undergraduate school and the speed with which they pass the notoriously difficult bar exam (i.e., on average it can take five years of study to pass the exam; a candidate passing on his first or second try would be well regarded). Although this may bear little relationship to lawyering skills, as noted earlier, that is also true in other countries such as the United States. In the Japanese context, these are the criteria by which firms signal the prestige of their new hires and the quality of the firm.

The legal reform program has resulted in a new bar exam for graduates of the new law schools, and it is anticipated that the bar passage rate will increase to the range of 70-80%. Recommendations of the Justice System Reform Council, *supra* note 133, at ch. III, pt. 2-2. Although this means that the law school attended will provide an additional factor in evaluating a new attorney, it is unlikely that firms' basic approach to identifying the top candidates for recruitment will change significantly.

149. Mergers inevitably attracted media coverage, raised firm profiles, and aided in recruiting, as new attorneys possess very limited information about law firms. However, there is little evidence that this effect was long term, especially since new mergers took precedence over prior mergers. In addition, a new Japanese attorney with an interest working at a Big Four firm could easily interview all of the relevant firms and base a decision on personal impression in addition to firm reputation.

150. See *supra* note 139 (describing the traditional firm structure in Japan which focused on a boss and followers). Although until recently there was no formal partnership or other legal structure available for law firms under Japanese law, some leading firms essentially replicated such a structure on a contractual basis. For example, although the firm's managing partner might sign an office lease in his individual capacity and not in the firm's name (as the firm was not a legal entity), the contract among the firm's partners would contain the necessary indemnification, contribution, and other provisions to essentially make the lease obligations those of all the partners, at least as an internal matter. Partner/associate ratios have traditionally been low, and until recently it was assumed that the Japanese practice of lifetime employment also prevailed among elite law firms, with every interested associate given a good opportunity to become a partner. With the rapid growth of elite firms in the last several years, which has centered on increased hiring of young attorneys, partner/associate ratios have also increased and the assumption of permanent employment is now beginning to change.

151. Lateral movement by Japanese attorneys is increasing, in response to new employment opportunities with foreign firms, corporations, and others. Kay-Wah Chan, *Foreign Law Firms: Implications for Professional Legal Education in Japan*, 20 J. JAPAN L. 55, 67 (2005), available at [http://law.anu.edu.au/anjel/documents/ZJapanR/ZJapanR20\\_08\\_Chan.pdf](http://law.anu.edu.au/anjel/documents/ZJapanR/ZJapanR20_08_Chan.pdf). However, hiring by the large firms has focused on new attorneys. Foreign law firms have been active in the lateral market, hiring both associates and partners. *Id.* at 68. It is still quite rare for a partner at a Big Four firm to make a lateral move.

included in this Article where, until as recently as 2005, restrictions on the activities of foreign lawyers were a significant issue.<sup>152</sup> The Japanese bar association has historically resisted liberalization of restrictions on foreign attorneys, citing concerns of professional autonomy and the social role of lawyers.<sup>153</sup> Foreign lawyers were first formally allowed to practice in Japan under a law passed in 1986<sup>154</sup> and were allowed to give advice on the law of their home country. They were not, however, allowed to hire or combine with Japanese lawyers.<sup>155</sup>

Legal services were an issue in U.S.-Japan trade negotiations, and the Japanese proposed a compromise solution: An amendment to the law in 1994 provided that foreign law firms could ally with Japanese firms in a joint venture relationship (*tokutei kyodo jigyo* or specific joint enterprise) and that the joint venture could employ both foreign and Japanese lawyers in a domestic (Japan only) partnership.<sup>156</sup> Foreign firms were still forbidden to hire Japanese lawyers directly or to form international partnerships with Japanese firms.<sup>157</sup> Although these joint ventures were initially insignificant, they have now grown to the point where a few of them provide some competition with Japanese firms (see Table 9). In 2003 the Japanese parliament passed a law that allowed full integration between foreign and Japanese law firms from April 1, 2005, and a number of the joint ventures merged with the foreign parent firm.<sup>158</sup>

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152. See J. Mark Ramseyer, *Lawyers, Foreign Lawyers, and Lawyer-Substitutes: The Market for Regulation in Japan*, 27 HARV. INT'L L. J. 499 (1986).

153. These concerns have often been greeted with skepticism outside Japan and not only by self-interested lawyers at international law firms. See, e.g., *id.*

154. See *Gaikoku Bengoshi ni Yoru Horitsu Jimu no Toriatsukai in Kansuru Tokubetsu Sochi Ho* [Special Measures Law Concerning the Handling of Legal Business by Foreign Lawyers], Law No. 66 of 1986. The law became effective April 1, 1987.

155. *Id.*

156. See *id.* It became effective January 1, 1995. In addition to formation of joint enterprises, it permitted foreign firms to use their firm names in Japan rather than forcing firms to use the name of the individual partner who registered under the law. It also eased professional experience and reciprocity requirements. Additional minor amendments were enacted in 1996 and 1998 to further liberalize the law. *Id.* (amended 1989, 1993, 1994, 1995, 1996, and 1998).

157. *Id.*

158. See, e.g., *Paul Hastings Announces Integration with Taiyo Law Office in Tokyo*, Sept. 12, 2005, available at <http://www.paulhastings.com/NewsDetail.aspx?NewsID=65>. This permits Japanese partners of the local joint venture to become equity partners of the international partnership. Other firms were content to change the names of the Japanese joint ventures. See e.g., *Clifford Chance Tanaka Akita & Nakagawa becomes Clifford Chance*, Mar. 30, 2005, available at [www.cliffordchance.com/default.aspx?langID=UK&contentitemid=8290](http://www.cliffordchance.com/default.aspx?langID=UK&contentitemid=8290).

**TABLE 9**  
**LARGEST FOREIGN JOINT VENTURE FIRMS**

Firm	Japanese Lawyers ( <i>Bengoshi</i> )	Foreign Lawyers ( <i>Gaiben</i> )	Total Lawyers
Tokyo Aoyama Aoki (Baker & McKenzie)	59	11	70
White & Case	26	24	50
Linklaters*	30	8	38
Ito & Mitomi (Morrison Foerster)	21	12	33
Taiyo (Paul Hastings)	25	7	32
Freshfields	23	5	28
Jones Day	24	3	27
(Current as of March 31, 2005)			
*Does not include effect of the merger between Linklaters and a group from Mitsui Yasuda, which became effective on April 1, 2005 (see Table 8).			
Source: 2005 White Paper, <i>supra</i> note 123, at 88.			

New interest in the legal market and law firms and the pending abolition of the remaining significant restrictions on the activities of foreign law firms also intensified interest in international mergers and alliances. With a growing domestic legal market with relatively few players, elite Japanese firms are content to be leaders in their domestic market, especially given the relative handicaps of Japanese language and expertise in Japanese law. But this was also presumably true for German firms. Lawyers within the Japanese bar association who opposed full liberalization of activities of foreign law firms pointed to the German example and warned that Japanese firms might also be swallowed up by global giants.<sup>159</sup>

This fear was put to the test by the first international merger in 2005 between Linklaters, one of the magic circle U.K. firms, and the firm of Mitsui Yasuda Wani & Maeda. Mitsui Yasuda was the number six firm in Japan—a firm which, like Rogers & Wells in the United States prior to its merger with Clifford Chance, engaged in sophisticated financial work but was nevertheless unable to break into the small group of first-tier firms. The press in both the West and Japan portrayed this merger, perhaps inaccurately, as a direct result of liberalization of the legal restrictions on foreign law firms.<sup>160</sup>

159. See Akira Kawamura, *Bengoshi Seido Henkaku no Sekaiteki na Choryu to WTO* [Global Trends in Changes in the Lawyers' System and the WTO], 53 JIYU TO SEIGI 14, 17 (2002) (citing the upheaval among German firms due to international mergers and alliances and the ongoing changes in Japan due to the establishment and operations of joint ventures with international law firms, and further predicting that complete liberalization of restrictions on foreign lawyers and law firms would cause a similar upheaval in Japan).

160. See, e.g., Jill Schachner Chanen, *Konnichiwa Bengoshi! Japan is Set to Relax Foreign Partnership Rules, and Competition for Mergers is On*, A.B.A. J. 19

Although the initial intention on both sides was for Linklaters to absorb the entire firm, Mitsui Yasuda split as a result of the proposed merger.<sup>161</sup> This unanticipated result may have had a chilling effect on the possibility of additional international mergers. Nevertheless, leaders of the Big Four firms, who consistently state that they intend to remain purely Japanese firms, all hedge their statements with references to competitive market conditions.<sup>162</sup> This presumably means that if a Big Four (i.e., first-tier) firm merged with a foreign firm or if one or more foreign joint venture firms became serious competitors of the Big Four firms, all of the first-tier firms would accordingly reevaluate their positions.

The latest announced merger is between the substantial international group of Asahi Law Offices, the fifth largest firm, and Nishimura & Partners, one of the Big Four firms (see Table 8).<sup>163</sup> This merger will be significant in that Asahi is not a specialized firm that would strengthen an important area of Nishimura's practice. Rather, it would appear to be the first merger in Japan where achieving size and increase specialization—becoming the largest Japanese law firm through a merger—can be viewed as an important, and perhaps even the primary, consideration for the larger firm.

(2005); *Legal Entry: Japan's Lawyers Discover Globalization*, ECONOMIST July 17, 2004, at 66; *Eihoritsu Jimusho, Mitsui Yasuda wo Kyushu, Kaisei Gaikoku Bengoshiho de Hatsu* [English Firm to Absorb Mitsui Yasuda, First Under the Revised Foreign Attorneys Law] NIHON KEIZAI SHINBUN, July 12, 2004, at 1. It is true that pending liberalization acted as an impetus for English (and U.S.) firms to begin a new round of approaches to Japanese firms. It also marked the first time that foreign firms could reward partners in their Japanese counterpart firms with full equity partnership positions in the acquiring firm. However, it is not entirely clear whether liberalization of the activities of foreign lawyers had a decisive impact on alliance/merger prospects. Over the last few years the foreign affiliated venture firms have grown substantially, function fairly well on a daily basis utilizing both U.S. and Japanese attorneys, and have learned to reduce the expense and inconvenience resulting from their joint venture structure to a bare minimum. In an interview with a leader of the Mitsui Yasuda group, which joined Linklaters, he downplayed the role of the new law and emphasized his desire to continue to focus on crossborder transactions at a time when the largest Japanese firms were shifting to a more domestic-oriented corporate practice. However, the new law probably did have a significant impact on perceptions, as a Japanese lawyer might be more willing to become a full equity partner in a London-based global firm than join a joint venture.

161. See Chan, *supra* note 151, at 60-63.

162. See, e.g., *Zadankai: Daikibo Horitsu Jimusho no Gendai to Shorai* [Roundtable: The Present and Future of Large-scale Law Firms] 57 JIYU TO SEIGI 12, 46-49 (May 2006).

163. The two firms signed an agreement in principle to integrate their law practices on April 14, 2006. See Nishimura & Partners: Commencement of Discussions Towards Integration with Asahi Koma Law Offices (2006), available at <http://www.jurists.co.jp/en/topic/2006/t004.shtml>. The merger became effective on July 1, 2007. See Nishimura & Partners: Nishimura & Partners and Kokusai Bumon International Division) of Asahi Law Offices to Integrate in July-To be the Largest Law Firm in Japan- (2007), available at <http://www.jurists.co.jp/en/topic/2007/t003.shtml>.

## VI. RECONSIDERING EXPLANATIONS FOR LAW FIRM MERGERS

### A. *Evaluation of the Case Studies and Reputational Competition*

The case studies demonstrate that law firm mergers have occurred not only in the United States, but in all of the countries surveyed. In large federal systems like Germany and Australia, regional firms used mergers to create elite, national law firms. But domestic mergers also occurred in England and Japan, countries where single-office national firms emerged in London and Tokyo and where mergers were undertaken to gain expertise, size, and reputation rather than to create national firms.

Law firms everywhere provide similar explanations for their mergers, citing client demands for specialization, larger teams of attorneys, and one-stop shopping, as well as the need for a credible mass or national (or global) platform. Although this may be true to some extent, it clearly does not fully explain firm behavior, particularly with respect to international mergers. As noted above, both the global U.K. firms and the more domestic-oriented U.S. firms cite client demand in support of their conflicting strategies. But did client demand lead to nine out of the top ten German firms entering into mergers or formal alliances in the course of a single year?

Consideration of reputational competition aids in providing a more robust explanation of firm behavior in the merger area. Although the three reputational elements work in an interrelated manner to affect firm behavior, the most directly observable element is the existence of an identifiable group of first-tier firms among the elite firms in every country surveyed. It turns out that the United States is the outlier among the jurisdictions examined. It has such a large domestic market for legal services (and particularly for capital markets and other high-value added services in New York) that first-tier firms have clearly favored profitability over expansion; expansionist strategies are followed only by a number of the other elite, non-first-tier firms. In other jurisdictions, with a smaller domestic market and fewer players, the first-tier firms are generally among the largest firms in the market, and the tradeoff between profitability and growth is less pronounced.

Although the strategies of first-tier firms may vary somewhat depending on the market, recognition as a first-tier firm is of supreme importance in all jurisdictions. As noted by Gilson and Mnookin, it is difficult to create firm-specific (or reputational) capital.<sup>164</sup> The rewards for success are great as reputations tend to be sticky. However, unlike the Big Four accounting firms, there is always potential for movement into and out of the first-tier group of firms.

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164. Gilson & Mnookin, *supra* note 19.

As a result, firms fight hard to gain admission, keep their good standing, and avoid falling out of the group. Although first-tier status is related to profitability, it is not solely a function of profitability, particularly outside the United States. Firms want to be recognized as belonging to the first-tier, which is a status above and beyond achieving a particular level of profitability.

This first-tier status is reflected by the fact that when a law firm successfully obtains first-tier status, its business strategy has a significant impact on other firms, including other first-tier firms. As noted earlier, Clifford Chance's success in entering the first tier following a merger of two non-first-tier firms caused widespread emulation of its global firm strategy by other English firms.<sup>165</sup> Clifford Chance's rise is arguably the largest single cause of three of the remaining four magic circle firms adopting such a strategy. The next group of firms below the magic circle, which aspired to gain first-tier status, adopted a similar strategy with negative results. These firms have all since retreated from that strategy of emphasizing growth over profitability and have been replaced by other firms in the group just below the magic circle.

Other examples of changes in first-tier status include Mori Sogo's joining the ranks of first-tier Japanese firms in the 1990s, which was a factor in other first-tier firms placing greater emphasis on the growing market for domestic corporate work in addition to their traditional transnational corporate practices. At the same time, firms perceived to be in danger of falling out of the first tier, such as Shearman & Sterling in the United States and Minter Ellison in Australia, have undertaken aggressive restructuring programs and other measures, which include a focus on restraining size and boosting profitability.

The reputational elements can be utilized, together with market size and competitive conditions, to formulate fairly consistent rules of the game for international mergers. First-tier firms are generally reluctant to engage in international mergers. This general desire to safeguard profitability over riskier investment in international growth is most pronounced in the large U.S. market. This U.S. approach is often contrasted with the Big Four of the five magic circle firms in the United Kingdom, which have embarked on global expansionist strategies. Although this is often explained in terms of the limited size of the U.K. domestic market and English firms' greater emphasis on globalization of clients' businesses, the competitive reaction to Clifford Chance's success in entering the first tier with an aggressive expansionist strategy had a significant

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165. See, e.g., *The Battle of the Atlantic*, ECONOMIST, Feb. 26, 2000 (quoting a senior partner at Clifford Chance as stating "We're leading the way, others will have to follow" and noting that "Rivals in London are already doing so."); *supra* note 80.

impact. In fact, a better counterexample to the U.S. first-tier firms would probably be Australia, where firms struggle in a relatively small market with intense competition and relatively low profitability. Being one of the dominant firms in a modest-sized, mature domestic market might not be as valuable as the potential for growth and diversification offered by an international merger.

If first-tier firms (at least outside of the United Kingdom) are generally reluctant to engage in international mergers, one group of likely candidates is the edge firms that are just below the first tier. Examples include Rogers & Wells' merger with Clifford Chance and Mitsui Yasuda's merger with Linklaters. In both cases the local firms presumably experienced frustration at being unable to break into the first tier despite their belief that their practices were equivalent to those of first-tier firms. And from the point of view of the U.K. acquirers, these edge firms represent the best firms available as merger partners since first-tier firms in both the United States and Japan have consistently rejected merger overtures from U.K. firms.

If, however, a first-tier firm does accept an international merger offer, such action results in a large competitive reaction, and all firms (both first-tier and other elite firms) reexamine their position on mergers. Although the surge of German international mergers in 2000 had a number of causes, the fact that a first-tier German firm accepted Clifford Chance's merger offer is highly significant. Even now, the remaining independent German firms have indicated they would reevaluate their positions if one of the U.K. firms were successful in finding a first-tier merger partner in the United States.<sup>166</sup> Similarly the Big Four firms in Japan all have suggested that they would reconsider their positions of maintaining independence if a foreign firm either merged with one of them or otherwise was able to attract sufficient high-quality Japanese attorneys to compete with them on an equal footing.<sup>167</sup>

Although the importance of first-tier firms is the most visible reputational element, the case studies suggest that other reputational elements are also significant. With respect to herd behavior, the wave of international mergers in Germany at the turn of the century is instructive. One popular argument is that the main cause was regulatory change (i.e., the creation of the Euro zone) and that a scramble for international merger partners also occurred, to varying degrees, in other countries throughout continental Europe. This is clearly relevant, but why would the leading German firms give up their independent positions in a country that is both the largest economy in Europe and a growing market for legal services?

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166. Sandburg, *supra* note 100.

167. Zadankai, *supra* note 162.



It is unlikely that all the leading German firms investigated the proposed regulatory changes and independently decided that either clients would now demand an international platform and one-stop shopping for legal services or that it would now be more efficient to provide legal services through an international merger instead of as independent law firms. Rather, looming, significant regulatory change was important precisely because the impact of the Euro zone was not yet known. This is an excellent example of how the lack of information on potentially significant changes to firms' operating environments can affect their behavior. Under these circumstances, it is perhaps unsurprising that a first-tier German firm accepting an international merger offer would trigger a large herd reaction in the form of a quick series of defensive international mergers.

Reputational signaling is perhaps the most pervasive reputational element but also the most difficult to observe directly. In the United States, the perception has become widespread that a firm must now be a national firm to muster the necessary credible mass and platform to be eligible for the short lists of large corporate clients. This is reflected in the lack of mid-sized general service firms located in cities like New York or Los Angeles. However, Germany is now effectively divided into a two-tier system of national firms and non-elite regional firms; the same division arguably appears in all of the countries surveyed. Even in Japan, it is now difficult to be a mid-sized firm (even if a mid-sized firm in Japan is fifteen lawyers rather than the 250 lawyers of a mid-sized firm in New York) for essentially similar reasons: Any firm that does not effectively signal to its clients and other constituencies that it is successfully adapting to changing market conditions is potentially at risk.

The lateral market for attorneys is one significant indicator of a firm's reputational standing and also acts as an indicator of the strength of first-tier firms. Although the lateral market is well established in the United States, first-tier firms do not participate in it, neither losing partners to other law firms nor accepting lateral partners.<sup>168</sup> The lateral market has become increasingly important in other jurisdictions like Germany.<sup>169</sup> The ability of English and U.S. firms to attract lateral partners from top German firms in the early-to-mid 1990s was a precursor of both an increasingly mobile lateral market and the wave of international mergers and alliances that occurred at the end of the decade. By contrast, the foreign-affiliated joint venture firms in Japan generally have been unable to attract lateral partners from first-tier firms. If they should be

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168. See Tom Ginsburg & Jeffrey A. Wolf, *The Market for Elite Law Firm Associates*, 31 FLA. ST. U. L. REV. 909 (2004) (discussing the lateral market in the United States and firms' "aversion to laterals").

169. See Smith, *supra* note 95.

successful in doing so, this presumably would have a significant impact both on firm competition and on the likelihood of international mergers occurring.

Any discussion of reputational signaling to law school students encounters the issue of possible constraints on the supply of new lawyers. In all the jurisdictions surveyed, elite firms complain about the lack of supply of highly qualified new lawyers, and there is certainly a need to attract well-qualified new lawyers to do the sophisticated legal work demanded by large corporate clients. However, as Table 1 indicates, the percentage of lawyers working at elite law firms is relatively low in all of the countries surveyed (with the possible exception of Australia).

Rather, elite law firms seek to hire new lawyers who will add to their prestige and act as a signal of their credibility. These firms emphasize prestigious academic records instead of attempting to find individuals who will do the best work. In the United States, this means limiting hiring to the top law schools. In Japan, where every new lawyer is successful on a bar exam with a 3% pass rate and Institute grades are unknown, law firms simply go back a step and emphasize the prestige of the undergraduate school and the number of attempts required to pass the bar exam.<sup>170</sup> In addition to using new hires as a reputational signal to all constituencies, firms also signal specifically to law students through competition in starting salaries.

This Article has not focused on a number of other factors that are cited in discussions of law firm growth and the international expansion of law firms. One factor is the regulation of lawyers, particularly the activities of foreign lawyers, in the context of international mergers. As prior constraints on lawyers have generally been lifted in developed countries, Japan is the only jurisdiction where this remains an issue. Although foreign joint venture firms first became permissible in Japan in 1994, they did not become significant until the last few years—following growth in the market for corporate legal services. Liberalization permitting international mergers, which occurred in 2005, has produced one such merger. To date, this has had a limited impact on the Japanese legal market, and one possible lesson from the Japanese experience is that beyond a certain threshold of liberalization, markets become more important than any remaining restrictions on foreign lawyers. In addition, restrictions on the activities of foreign lawyers are still significant in developing countries, which were not included in this survey.

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170. See Milhaupt & West, *supra* note 147, at 463.

### B. *Convergence or Parallel Development?*

One interesting question raised by a comparative analysis of law firm mergers is how to account for similarity in merger trends in several countries. Given the international influence of the U.S. model of elite law firms and some broadly parallel developments in the United Kingdom, could this constitute the "Anglicization of professions worldwide" predicted by one commentator over a decade ago?<sup>171</sup> Or, in terminology used in comparative corporate law, could this represent a convergence of elite law firm practice and structure toward a U.S. or Anglo-Saxon model, or does it represent a form of path dependence?

In a broad sense there is an underlying trend for elite firms in all the jurisdictions surveyed to grow larger and more specialized and to provide some form of one-stop shopping, at least at a national level. And firms in a number of countries, including Japan, contain many lawyers who received advanced training in the United States and who may look to the U.S. model of the elite law firm in the course of developing their own practices. Having said this, however, one should be cautious in making sweeping generalizations concerning law firm development.

Creating an Anglo-Saxon model of the elite law firm involves constructing a broad stereotype and necessitates ignoring significant differences between U.S. and U.K. firms. These include their differing views on profitability versus growth, international expansion, and performance-based compensation versus lockstep compensation. This model would also lump together first-tier firms and other elite firms, despite their considerable differences in strategy.

An alternative explanation of merger trends would be that law firms everywhere are reacting to similar phenomena: deregulation (particularly of financial markets), consolidation of clients and changing client-law firm relationships, economic globalization and technological change, and greater availability of information on law firms. Even when lawyers overseas state that they are consciously looking toward the model of U.S. law firms, one could argue that what they are really focusing on is the U.S. model of practicing law in the narrow sense—the model of advising large corporate clients on complex, significant matters by developing expertise and mobilizing teams of lawyers across practice areas. Lawyers in other countries may feel free to ignore the practices of U.S. firms in terms of both

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171. See Flood, *supra* note 65, at 572.

strategic decisions, such as international strategy, and more importantly, on matters of internal structure.<sup>172</sup>

Consideration of reputational elements adds to an understanding of the broadly similar yet diverse reaction of law firms to similar phenomena by emphasizing the inherent difficulties in evaluating and monitoring the quality of work of law firms and the effect of such uncertainties in a changing environment. To the extent that similar changes such as deregulation and industry consolidation are occurring generally, elite law firms in other jurisdictions would face the necessity of signaling their continuing quality and credibility to their constituencies and their successful adaptation to new conditions. If so, it might be unsurprising, given their essentially similar constituencies, that firms do so in similar but not identical ways. Under such circumstances, herd behavior indicates that many strategic decisions are defensive in nature and are often designed to prevent a firm from falling behind its competition.

## VII. CONCLUSION

This Article has not attempted to disprove any of the popular explanations given for law firm mergers. Those theories include the demand-side arguments that clients want one-stop shopping at large, global law firms and that law firms may be considering the theory of the firm efficiencies related to size and mergers, as well as the supply-side theories, which emphasize law firms' internal structures as driving growth. Rather, skepticism concerning the ability of any of those views to explain fully law firm behavior in the real world led to an effort to extend the current literature and consider reputational competition through an examination of the combined impact of a number of reputational elements on firm behavior.

The elements of reputational signaling, herd behavior, and the role of first-tier law firms aid in providing a more robust, multi-causal explanation for the puzzle of conservative lawyers and law firms apparently engaging in uncharacteristically risky behavior. Firms do so, to a significant extent, because quality is hard to measure, and industrial consolidation and increased law firm competition have

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172. It is interesting to note that the co-authors of a paper on Japanese elite firms responded with somewhat different views to the question of whether Japanese elite firms had looked to U.S. firms as their model. See Nagashima & Zaloom, *supra* note 131. Yasuharu Nagashima, founding partner of one of the first-tier firms, Nagashima Ohno & Tsunematsu, essentially said yes, while E. Anthony Zaloom, a lawyer with long experience in U.S.-Japan practice working at both U.S. and Japanese law firms stated that Japanese firms had adopted the practice style of U.S. firms, but not the management style. Yasuharu Nagashima & E. Anthony Zaloom, Remarks at Conference entitled "Law in Japan: A Turning Point" (Aug. 23-24, 2002).

made firm reputation more important than ever before. The circumstances that are likely to lead to mergers are discernible and, in the case of international mergers, can even be articulated as fairly consistent rules of the game.

A comparative perspective has been useful not only to help formulate the relevant rules of the game for international mergers, but also to illuminate aspects of the U.S. legal system. One might have been under the impression, for example, that it was *The American Lawyer's* ranking tables and aggressive law firm consultants that caused gentlemanly U.S. law firms to transform into cutthroat competitors and engage in a wave of mergers in the United States. However, growth and law firm mergers have occurred in many countries, including jurisdictions where neither ranking tables nor law firm consultants are prominent.

In fact, in a sense it is the United States that is the outlier among the jurisdictions surveyed. The market for legal services, and especially the deep market for highly profitable financial services concentrated in New York, allows first-tier firms to pursue a clear strategy of emphasizing high profitability over growth, which separates them from other elite firms. This clear division is less evident in other countries, such as Australia, which have smaller markets and fewer players. The popular debate contrasting the profit-maximizing, domestic U.S. firms and the growth-oriented, globalizing U.K. firms is interesting but is also something of an oversimplification. All such comparisons involve differences in strategy among a handful of first-tier firms in each country. More importantly, the globalizing strategies of the Big Four U.K. firms do not result simply from the relatively small size of the U.K. domestic market and strongly held views on future client demand for global services. Their strategy was also heavily influenced by a specific, historical event—the expansionist Clifford Chance breaking into the ranks of first-tier firms in the United Kingdom and the strong competitive reaction to that success.

This initial survey may raise more questions than it answers and suggests many avenues for further research. Two common presumptions underlying popular explanations of law firm mergers remain untested: whether clients truly demand one-stop shopping at large (possibly global) law firms and whether firms give any real consideration to theory of the firm efficiencies related to size and mergers. Also, due in part to a scarcity of reliable comparative data, this Article does not attempt to compare law firms' internal structures and compensation systems. However, such a comparison would clearly be relevant for a firm's classification, strategy, and behavior and deserves further attention.

Another question relates to the availability of information and the role of law firm rankings and the legal press. Although law firm market information is prominently featured in reputational signaling

(see Diagram 1), the actual role of an active legal press is unclear. Some law firm consultants in the United States have argued that the main influence of law firm rankings is on the lateral market, as they provide potential lateral partners with access to reliable measures of firm profitability on a comparative basis.<sup>173</sup> This view, however, remains untested.

Although this survey is limited to selected developed countries, a similar analysis could be extended to developing countries. Law firms have been growing quickly—and merging—in a number of developing countries such as India, where a 2006 merger formed that country's largest firm of 250 lawyers.<sup>174</sup> China's legal market, particularly in Shanghai, is also booming. An examination of developing countries might well require additional consideration of the role of the regulation of the activities of foreign lawyers.

This Article also suggests that it may be difficult to define a single model of the U.S. or Anglo-American law firm and that the common phenomenon of law firm mergers in a number of markets likely reflects the parallel development of the law firms' reactions to similar types of changes in their operating environment, rather than convergence to an Anglo-American model of the law firm. Yet some U.S. law firm practices may have significant influence on elite foreign law firms, even if U.S./U.K. firms do not serve as an overall model.

Finally, the ultimate question is how to measure the success of law firm mergers. This is a difficult area with very few studies and no widely accepted metric for measuring success. Law firm consultants state that the ultimate measure of a merger's success is how well it effectuates a firm's underlying strategy, and they view a merger as a tool, not a strategy or goal in and of itself. Yet the present difficulty in measuring a merger's success adds another element of uncertainty. This uncertainty is arguably a contributing factor to firms' focus on reputation and to the phenomenon of law firms entering into defensive mergers as a default strategy in response to the fear of being perceived as falling behind the competition. This fear has been, and will continue to be, a powerful factor in mergers, international alliances, and other strategic decisions by firms.

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173. See, e.g., Michael Aneiro, *The AmLaw 100 2005: Profitability Theory: At Some Firms, Complex Compensation Formulas Have Blurred the Once-Bright Line between Equity and Nonequity Partners*, AM. LAW., July 2005 (noting that "The strongest influence of profits per partner is in the lateral hiring market" since "[i]t offers candidates a quick snapshot of what they might earn and how much they could command down the road").

174. Jennifer Moline, *Merger Creates India's Largest Firm*, July 27, 2006, <http://www.law.com/jsp/article.jsp?id=1153904732863>.

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