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Entrance barred to the magic circle

By Claire Smith

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When Australia's Macquarie Bank started considering a bid for the London Stock Exchange this year, most observers assumed finding an English lawyer would be the least of its problems.

In fact, Macquarie was just the latest in a long line of frustrated bidders that, when they decided to make a major acquisition, discovered the lawyers they wanted to instruct had a conflict of interest.

Refused by many of the leading mergers and acquisitions law firms, Macquarie turned to Baker & McKenzie, which in a ranking by Mergermarket, an M&A research company, did not make the top 20 of advisers in Europe on high-value M&A in the first half of 2005.

M&A activity is returning to something like the levels of the late 1990s. Since that time there has been a transformation in the English legal market. A combination of dramatic growth of the top six law firms, protracted auction processes in take-overs and clients demanding exclusivity from their lawyers, means getting the lawyer you want is tough.

The six largest English law firms - the so-called magic circle - have changed a lot since the last M&A boom. Between them, Clifford Chance, Allen & Overy, Freshfields, Bruckhaus Deringer, Herbert Smith, Linklaters and Slaughter and May now boast 12,000 lawyers, double their number in 1998. Of the 12,000, fewer than half are in London.

With globalisation has come an inevitable growth in the worldwide client base. Furthermore, as companies introduce legal panels in order to manage their relationships with a number of law firms, so the chances of a legal adviser having a conflict of interest increases.

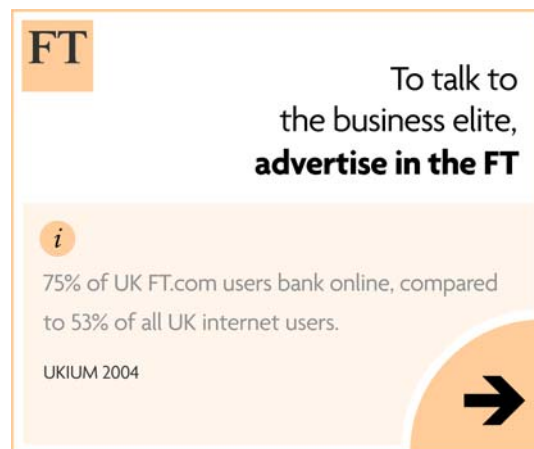
Slaughter and May, for example, had long-standing relationships with both Boots and Alliance Unichem, and so was forced to refer the latter to another law firm on the pair's £7bn merger. As Boots was also auctioning its healthcare division, attracting bids from GlaxoSmithKline and Reckitt Benckiser among others, Slaughter and May found four of its key clients were involved in one deal.


Christopher Saul, the firm's head of corporate finance, says: "Where FTSE companies do deals with each other, conflicts have been an issue for us, as we are fortunate enough to act for a good number of FTSE clients."

In auction processes the problem is particularly acute, says Michael Walter, the head of corporate finance at Herbert Smith. "If a vendor is putting assets up for auction, it's not unusual to get a dozen or more interested parties. For the biggest deals, there are a limited number of law firms equipped to handle them, and the number of such firms is smaller than it was 10 years ago."


What's more, because the same few firms attract so many of the largest deals, their experience and expertise in handling them grows and the situation becomes a cycle that it is difficult for others to break into, he says.

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Keith Clark is international general counsel at investment bank Morgan Stanley, and was previously chairman of Clifford Chance.

He is the editor of *Conflicts of Interest*, a new book dealing with jurisdictional comparisons of conflict laws for financial services, accounting and legal professions.

He says: "In the London marketplace, you have a situation where you have got half a dozen law firms servicing a huge number of the big transactions, whereas in New York you have far more law firms. When you get into hostile M&A, those conflict issues really come into play."

He believes the situation will only get worse. "A large number of hostile transactions now involves companies with parts of their operations in different countries, so the ability to service a deal across a variety of jurisdictions is more significant than it was last time around. That tends to consolidate the work into larger law firms, which have either developed their own operations overseas or have relationships with the leading firms in those jurisdictions."

In America, the rules governing lawyers are stricter. In England, the legislation is largely transaction-specific: a law firm must not act for one client if it is doing something adverse for another client on the deal. In the US it is a client-specific approach: a firm must not act against the interests of a client of the firm, even in a wholly unrelated matter, without consent.

Peter King is a partner in the London office of New York law firm Shearman & Sterling. He says: "We are seeing clients increasingly taking the US approach. Also, there was a time when clients liked you to be acting for other companies in their sector, so you had industry expertise. Nowadays the big mining companies, for example, will say: 'If you act for us, it's completely out for you to act for one of the other major mining companies.'"

All of which means, as the market for acquisitions once again heats up, clients are having trouble hiring the lawyers they want.

Nick Deeming is group legal director and company secretary at BOC Group. He says he had a conflict of interest problem when he wanted to take action against a bank. "Immediately you mention pursuing a bank, it seems all the magic circle firms are conflicted," he says. "My first reaction was one of disappointment but it made me delve around the market and see who else could help me. I came up with a better firm."

In another situation, he was forced to do the legal work in-house on a major commercial contract because his law firm also advised the other party in the negotiation. He says, "There's a mindset that you need to use one of the big firms, and in boardrooms they expect to see the magic circle on their deals. The general counsel has to manage that, find people that are just as good elsewhere, introduce them to the board and manage those relationships."

Mr Deeming does enter into long-term exclusive relations with specific legal advisers because it can leave a company wedded to a law firm and then exposed should that firm have a conflict of interest: "That's when you end up scrabbling around."

Law firms are more selective about what they take on. William Charnley, senior partner in the London office of Chicago firm McDermott, Will & Emery, says: "We have to watch what sort of clients we take on and why we take them on. We wouldn't take on individuals or smaller clients, because there could be issues of conflicts in the longer term."

As a smaller operator in London - the firm has 80 lawyers here - McDermott is one of a host of US law firms expanding in the UK and seeing an opportunity to act for companies turned away elsewhere. "We find ourselves on major transactions on a regular basis, both in the US and in Europe, often because we were doing tax work or benefits work for the client, and then there's a conflict and we get the chance to do corporate work," says Mr Charnley.

Not all clients are happy to venture outside the top six. But few are likely to continue to have a choice.



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