

ALB SPECIAL
REPORT

CHINA 09

Continuous Revolution

As western markets went into freefall a year ago with company collapses and banks going bust, Asia – particularly China – was being viewed as the brightest light in an otherwise overcast economic sky. Top-line economic growth exceeded even the ‘conservative’ 6% that was predicted by the World Bank.

It’s not difficult to see why, with a host of local companies having the wherewithal, risk appetite and capital to strike overseas and domestic deals. The country’s recent stellar economic performance (or for that matter, over the past 30 years) shouldn’t obscure an important emerging reality. As far as China has come, it still has much further to go. And lawyers will have a central role to play.

Whereas in the past it was relatively easy to draw a distinction between the roles of international and domestic lawyers, the last six months have shaken up the complexion of the legal services market. The impulse to grow, while never abating in China’s expansionary domestic law firms, has been thrown into overdrive by the financial crisis. Headcounts have swelled exponentially, offices have been opened at break-neck speed and domestic law firms are fast attaining a quality some thought was the exclusive province of international firms.

China’s firms have racked up the lead roles on securities deals and mega-M&A transactions and snared the international clientele to prove it. There is a seismic shift underway in the legal services market – a continuous revolution – and it’s seeing local firms become international.

State of the market

The complexion of the legal services market over the past year was in many ways a carbon copy of that seen elsewhere in the region. Inbound M&A volumes dried up, securities and capital markets work disappeared (seemingly overnight) and the mega-deals were replaced instead by a trickle of less frequent but large ‘strategic’ outbound investments.

Work in counter-cyclical areas such as dispute resolution, insolvency and restructuring came into its own.

In other places there was little hope for a speedy recovery; in China, it was only a matter of months until things returned to normal.

If recent activity is anything to go by, the Chinese market has bottomed out and is on the upswing. Deals of all sizes are again flowing freely and securities work such as A-share listings and red-chip offerings are back. Boards are lighting up as deals such as CSCEC’s US\$6.2bn offering, Zhongwang’s US\$2bn IPO, 361 Degrees and BaWang push through. It will only become busier, according to lawyers ALB interviewed.

“In late 2008 and in the first quarter of 2009, there was talk of China leading economic resurgence and it has,” says David Liu, a partner with Jun He.



David Liu, Jun He

“On the transactional side things were slow, but even then we could sense clients were positioning themselves ... there was a feeling that the market wouldn’t be down for long and for lawyers there was a need to be patient, to wait for the market to bottom out. Judging from what we have seen over the last few months, we are now at that stage.”

Outbound M&A – rather than inbound volumes – has been at the centre of this rebound. This is shown by deals such as Chinalco’s quest for a US\$19bn stake in Rio Tinto, Yangzhou’s acquisition of Australian miner Felix Resources and CCB’s acquisition of IAG’s consumer credit business in Hong Kong.

But whether the outbound activity will continue once the markets return to ‘normal’ and inbound activity picks up is another story.

“[The move] away from inbound investment to outbound investments is understandable, due to problems

in other parts of the world ... but we think it will come back,” says Peter Charlton, Clifford Chance’s foreign legal consultant in the Hong Kong office.



Peter Charlton, Clifford Chance

“We do think that Asia, particularly China, is still on the radar as an opportunity for international investors, but its difficult to predict when significant inbound work will pick up.”

These will be changes that are sure to present local practitioners with a number of challenges in the months ahead.

Just as global economic slowdowns affect macroeconomic change, so too do they cause paradigm shifts to things such as the business development strategies of law firms and the fabric of the legal market itself. Such changes will ensure that practicing law in a legal market in recovery will be a markedly different proposition from practicing law in the good times.

Changes are good

Even the most cursory glance at the empirical data offers an indication of how the domestic legal market has shifted since the onset of the financial crisis. In just over 12 months, most of the country’s leading domestic law firms have grown, at rates unimaginable elsewhere.

Dacheng increased its headcount by just under 300 – it is now unrivalled as the country’s largest firm by numbers, with 835 lawyers.

King & Wood increased its staff count by 150, DeHeng by 270, Grandall and Allbright by nearly 50.

▶ CHINA’S LARGEST DOMESTIC LAW FIRMS

| Rank | Firm | Total lawyers and partners | Managing partner | Offices |
|------|-------------|----------------------------|------------------------|---------|
| 1 | Dacheng | 835 | Wang Zhongde | 28 |
| 2 | King & Wood | 800 | Wang Ling/Wang Junfeng | 16 |
| 3 | DeHeng | 675 | Wang Li | 14 |
| 4 | Grandall | 419 | Multiple | 10 |
| 5 | Jun He | 338 | Xiao Wei | 7 |

Source: ALB 50

▶ 2. CHINA’S LARGEST INTERNATIONAL LAW FIRMS

| Rank | Firm | Total lawyers and partners | Managing partner |
|---------|---------------------|----------------------------|--------------------------|
| 1 | Baker & McKenzie | 98 | David Fleming |
| 2 | Freshfields | 60 | Teresa Ko |
| 3 | Gide Loyrette Nouel | 55 | Han Qimeng, Yan Lan |
| equal 4 | DLA Piper | 54 | Roy Chan, Liu Wei |
| equal 4 | Jones Day | 54 | Winston Zhao, Peter Wang |

Just as these firms' lawyer numbers have grown, so too has their regional and international footprint. Dacheng now has over 28 offices, four internationally, which is 13 more than in 2008, DeHeng has opened four additional offices and King & Wood has opened three, including its much-publicised New York office.

(It should be noted that in addition, Jun He, Shanghai-based firm Richard Wang & Co and Shenzhen-based firms Guanghe and Shujin also have a United States presence).

Is this slightly counter-intuitive in an environment where some of these firms' international counterparts have downsized – or are actively looking to pare back their operations? Zhang Yi, a partner with King & Wood and head of the firm's Shanghai operations, doesn't think so. He says that it's not always accurate to compare international and domestic firms on this point, as growth for local firms is often motivated by a different set of concerns.

"The local legal industry is still developing so it's no surprise to see that many are still focusing their attention on achieving growth," Zhang says.

"The size of the firm is important as the deals that happen here, both inbound and outbound, are extremely complex and often require teams of lawyers. Firms that do not have the critical mass simply can't compete. It's a different proposition for international firms as they have access to lawyers in



Zhang Yi,
King & Wood

countless branch offices."

Cover all areas

Nevertheless, it's not necessarily about having offices scattered across the world. King & Wood's and Jun He's global visions notwithstanding, sometimes it's about having people on the ground across China itself, which is equally as important.

The past year has been a watershed in this regard. Strategic change was governed not only by the concerns of organic growth but by fundamental demographic shifts in Chinese society and that of clients.

Where in the past the growth of law firms was more or less solely dependant on the events transpiring in the powerhouse economies of Beijing and Shanghai (and to a lesser extent, Guangzhou) now many other fast-growing 'second-tier' cities are being mentioned in the same breath.

Places like Chengdu, Tianjin, Qingdao, Jinan Fuzhou and Xiamen, together with the Bohai Rim and Western regions, are among the most exciting prospects for growth. ALB finds many domestic law firms busy planning growth strategies around these locations as the story of China's miracle starts to spread inland.

"Beijing and Shanghai play a positive role as the economic powerhouses of the country ... due to their special locations and statures," says Charles Guan, a partner with Grandall. "[But]



Charles Guan,
Grandall

some cities in the central and western regions of China as well as cities in the west-bank economic regions will also benefit on the growth of law firms."

However, the more developed regions such as the Pearl and Yangtze River Deltas also continue to provide high-end, quality legal work and ample opportunities for the growth of legal practices.

"The Yangtze River Delta region is



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crucial to our development, and I would imagine that of our competitors,” says King & Wood’s Zhang. “It is home to a new class of wealth creator and entrepreneur and the region is in real need of high-calibre commercial lawyers, who are able to assist companies from places like Zhejiang, Jiangsu, Anhui and Fujian in fulfilling their international aspirations.”

According to Jun He’s Liu, branch offices mean nothing unless they are complemented by a similarly wide swathe of services. This is another area to have undergone substantial change in the past 12 months. “Long-arm service or a critical mass of offerings is just as important,” he says.

“A firm needs to be able to demonstrate to clients that it has the ability to do the big deals, that it has the people and the resources to do things like due diligence, to make sure that if anti-trust, IP, trade or other matters come up in a cross-border deal, that your firm can handle them and they won’t need to be outsourced.”

Most of the country’s largest domestic

firms have sought to bring their practice offerings to ‘critical mass’ over the past year. King & Wood, Grandall and Jun He have all invested heavily in developing their expertise in ‘new’ areas of the law such as anti-trust, anti-dumping and trade, outbound FDI, insolvency and restructuring.

Unveiling the new

But just what lies beneath this change? A simple explanation may be found in the fact that growth – and the changes that accompany it – are merely consequences for a legal market that is still itself developing. Those lawyers that *ALB* interviewed agree it has as much to do with the competition that the country’s leading domestic firms face, from all segments of the market.

“The local firms in the first tier of the market face the same strong competition that they always have,” says Liu. “But what is different now is that there is more competition coming from the second and third tiers of the market. In emerging areas like anti-dumping, anti-trust, trade and some securities areas

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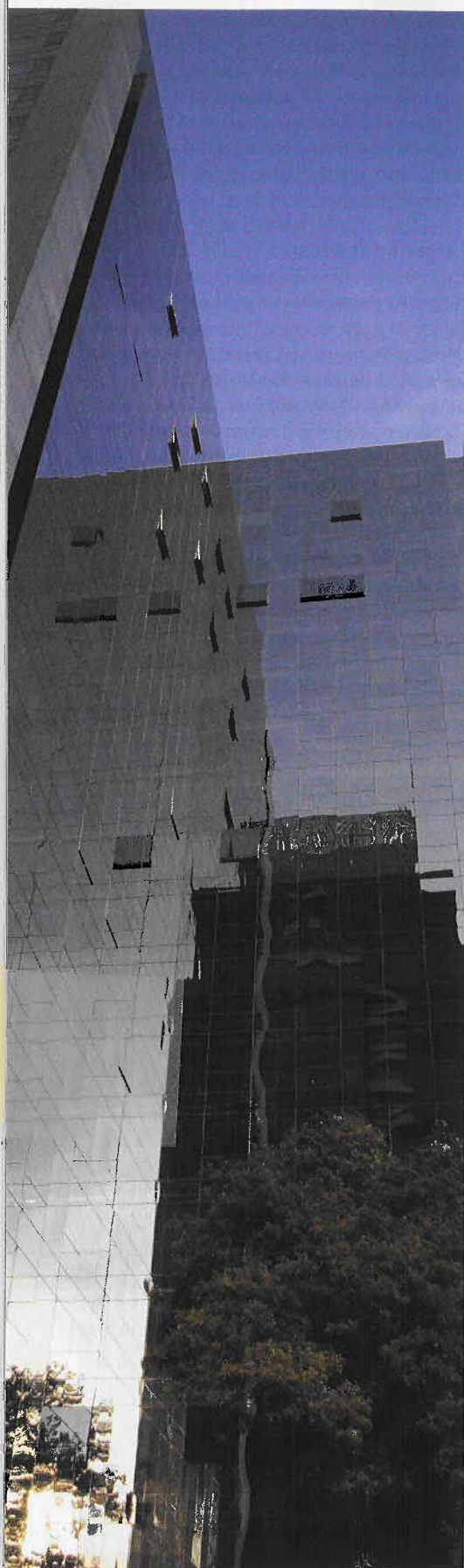
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they are doing better and better and their rise should be noted.”

Others are also feeling the pressure. “The boutique and specialist practices that are setting up now present a very strong challenge to the larger firms,” says King & Woods’ Zhang. “Their partners are either from international law firms or have extensive international experience and they are capable of handling high-end work. It is getting to the stage where there are no question marks over their quality – as there may have been previously.”

It is not only in niche areas that the country’s larger firms are feeling the heat. “Competition between domestic firms in the area of general corporate [work] is most apparent,” says Grandall’s Guan, “because such practice has lower barriers and, for most of the law firms, is the fundamental for them to maintain their daily operations.”

But the increasing sophistication of China’s mid-tier and boutique firms that Zhang, Guan and Liu talk of is not only limited to these players.

International law firms and those in-house lawyers *ALB* interviewed agree that this applies to all domestic firms in the Chinese legal market, so much so that as much as the larger firms face stern competition from emerging boutique and specialist law firms, they are also now at stage where they can challenge the international law firms for a slice of their market share.

Playing lead counsel

There has always been – rightly or wrongly – a qualitative stigma attached to domestic law firms in China. Ever since laws were passed allowing them to practice, there were misgivings about everything; from their service standards and ability to handle the big deals, to the technical skills of employed lawyers.

Such views, if they were ever true, are being quickly dismissed in a market that is hurtling towards maturation. “The capacity of local law firms to provide high-calibre international advice is increasing by the day,” notes Robert Lee, a partner with Diaz Reus.

“Lawyers within these firms are technically sound and have international experience gained from studying overseas and working in

international firms. They are playing a role in lifting standards across the board.”

Standards seem to be increasing to the point where many international firms cite domestic firms as definite rivals in the Chinese legal market. “In some areas of outbound and inbound work, they are definite rivals for international firms,” says Lee. “They have local knowledge and access to regulators which some internationals do not have.”

David Flavell, Danone’s general counsel for Asia Pacific, shares Lee’s view. He believes more intense competition between domestic and international firms will be a defining feature of the Chinese legal sector in recovery.



David Flavell,
Danone

“Local firms appear to be managing better [during the financial crisis],” he says. “I expect the leading local firms to continue to grow and continue to provide active competition for the international firms.”

While Clifford Chance’s Charlton does note that standards have improved, he says that despite the increasing sophistication of PRC firms they still can’t match the international firms’ global networks. “On average I would say that international law firms are becoming more competent and this is a gradual process,” he notes.

“But what PRC firms don’t have is the gateway that international firms can offer to the world outside.” Charlton adds while PRC firms can handle the local law components of inbound and outbound deals with great aplomb, they often lack the experience needed to project manage the biggest M&A deals.

These are deficiencies which domestic firms concede they have some ground to make up, but according to Jun He’s Liu, many are making inroads. “International law firms are ahead of domestic law firms in terms of the work they handle and the role they play on some deals,” he says.

“In the past you could have probably said that it was international firms who played the lead counsel on deals and the Chinese firms who did housekeeping, but this is now changing. Chinese firms are playing more important roles and it’s not only [on] outbound deals.”

“We are making good gains on



Robert Lee,
Diaz Reus

inbound deals as well," he says. This is something which appears to be evidenced by the firm's roles in deals such as Shui On Construction's US\$400m acquisition of China Central Properties, and Sichuan Tengzhong's acquisition of the Hummer brand from General Motors (GM).

To some extent, instances such as these are still considered out of the ordinary, according to Lawrence Liu, the chief legal officer of China Electronic Systems Corporation and chief representative of the Association of Corporate Counsel. He says that data which the ACC collects



Lawrence Liu, ACC

suggests that 90% of international legal work in the country for the first part of 2009 is being done by international firms. This is proof, Liu notes, that "international firms are superior to the domestic [firms]."

However, he does outline measures through which domestic firms can improve their offerings. The secret, Liu says, is increasing their exposure to international law firms operating in the country. "Local law firms are intending to provide more of an international quality of service, which means they will be performing and executing more internationally, he says. "They will need to learn from foreign counterparts and then provide good services for clients." This is a

"The capacity of local law firms to provide high-calibre international advice is increasing by the day. Lawyers within these firms are technically sound [and] have international experience"

ROBERT LEE, PARTNER, DIAZ REUS

process which has been occurring over the last two decades.

Danone's Flavell doesn't necessarily agree with Liu's sentiments, instead stating there is a wealth of technically adept lawyers at international and domestic firms for in-house lawyers to choose from. "I think it is a case of Western companies getting used to working with local firms and vice versa – cultural differences need to be respected and understood on both sides," he says.

"There are very good lawyers in local and international firms and we choose our legal providers based on the individual lawyers, rather than which firm they are with."

On the qualities he is looking for in his external legal advisors, Flavell says that what he expects from international law firms is no different from what he wants from local firms. "We want lawyers who take responsibility for their work and have a genuine interest in helping us achieve

commercial outcomes," he states.

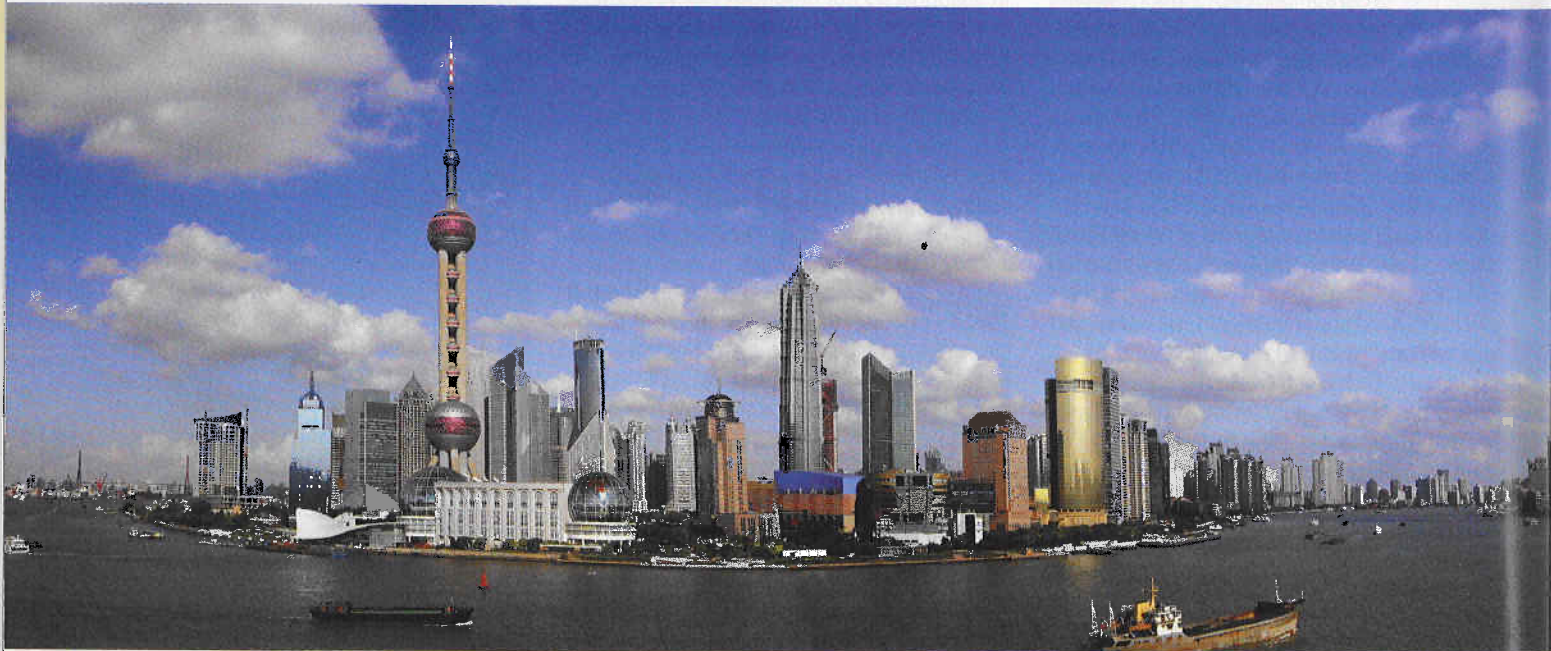
"External lawyers should not measure their success by whether they provide a technically correct answer. Rather, they should be proactive in suggesting better ways of doing things and challenge us where appropriate, and provide technically correct answers in a commercially usable form."

Liu's requirements are similar. He says that in addition to providing legal services more efficiently and being more responsive, external lawyers should aim to create an open dialogue between themselves and their in-house counterparts.

"External lawyers [should] provide greater resources to assist on clients' transactions, and provide some opportunities for in-house teams to do legal work together."

Talent war

Rivalry for international transactional work isn't the only area where the competition between international and



domestic law firms is apparent. The battle for the best and brightest legal talent is another place where the two models compete.

Whereas in the past it was more common to talk of international law firms poaching legal talent from domestic firms, the situation seems to have reversed since the onset of the financial crisis. More lawyers are now willing to make the move from international firms to their local firms on the mainland.

Why the change? Jun He's Liu believes it is influenced by the increasing stature of the nation's top domestic law firms and the often-faster progression opportunities that being part of a domestic firm offers.

"Chinese lawyers employed in international firms have seen that domestic firms handle high quality work and can offer them a clearer path to partnership," he notes.

"Because of these factors we have seen a shift in the employment market. We should not forget also that the work being handled by the big local

firms requires the skills of lawyers in international firms, so at the moment there is a need for their services."

King & Wood's Zhang adds that the discomfort being experienced by many international firms at the moment is another factor. "When compared to some international firms in China, domestic law firms are relatively more stable," he notes.

"Few have laid staff off and are either holding steady or looking to expand. This means a lot in the current employment market and is a big positive for lawyers looking to make a career move."

China's international firms are stepping up their efforts to attract and retain their talent, so the status quo may be restored sooner, rather than later. "We as a firm realize the importance of [having] bilingual, internationally-qualified talent on the ground," says Clifford Chance's Charlton.

"But we have been looking at ways to address this and [it] involves giving these lawyers exposure to our high-end work, offering them things such

as LLM courses to broaden their experience."

Diaz Reus' Lee cites a similar rationale that is underlying his firm's growing local practice.

"We were only officially licensed to set up in Shanghai in March this year. We are in a building phase at the moment and looking to bring on board PRC lawyers with excellent credentials and technical abilities," he says.

"Our strategy will be based around exposing these lawyers to the international work they crave and showing them that there is a clear path for progression within our firm."

Whether or not the exodus of Chinese lawyers away from international law firms and towards the welcoming bosom of domestic firms is a long-term trend or a mere flash in the pan remains to be seen.

It's clear however, that firms – whether they are international or domestic – can't rely solely on the leverage created by their brand, in what appears to be a rebounding recruitment market. **ALB**

The Diaz Reus competitive advantage

The market for legal services in China is fast becoming saturated. With so many players, it is often difficult to distinguish one firm from another. In this crowded market, however, Diaz Reus stands out. With a global practice, spanning the United States, Latin America, and now the Far East, Diaz Reus' team of lawyers, solicitors, and professional staff are reshaping the global practice of law. The firm's China Practice Group Leader, Robert Lee, tells *ALB* what separates his firms the rest



Asian Legal Business: Your firm received its license to establish an office in Shanghai in March of this year. How have things progressed? What is your China strategy?
Robert Lee – Diaz Reus: It's been extremely busy for us since we set up our Shanghai office. China has long been in our plans and our lawyers were working around the clock on plenty of cross-border disputes and corporate matters like project finance and M&A, so the granting of a license has allowed us to expand by following our international clients and setting up a physical office. Importantly, the license also gives us access to domestic Chinese clients. Our strategy in this regard is simple: in order to be competitive we have created a law firm that will focus on international practice in emerging markets, of which China is certainly one.

ALB: Your firm has previously stated that it's the BRIC nations, Brazil, Russia, China and India, which are the focus of the firm's strategy globally. How does this work?

RL: Over the past few years, we have witnessed a dramatic increase in patterns of trade relations between BRIC countries and interest from western countries, especially the US and Europe, in the growth story occurring in these countries. This interest spans all

sectors from FDI, M&A, strategic investments, and natural resources such as energy and natural resources. Similarly, the amount of investments we have seen have no limit, ranging from multi-billion to multi-million dollars. The work generated here already for our firm has been enormous and keeping our offices very busy.

ALB: In your opinion, how has the financial crisis affected your clients' BRIC interest? Has there been a decline in interest like elsewhere in the world?

RL: The global financial crisis has slowed things down, but the BRIC countries haven't lost their appeal, especially in terms of activity between BRIC nations. China's interest in Latin America, especially in terms of M&As, JVs and direct investment in mining and minerals, continues as does the two-way interest between Russia and the PRC in respect to sectors like oil & gas and natural resources—the interest of course is spurred on by China's need to find the natural resources to feed its manufacturing and economic engines. For these reasons, China's interests in the Middle East continues and a relatively newer trend is Chinese interest in resources in Africa. Our clients' demand for which may well see us open an office in Africa soon.

ALB: What do you feel are Diaz Reus' competitive strengths? Do you feel your size or niche offering put you at a disadvantage when compared to international firms?

RL: On the contrary, I think our size and our niche focus give us a competitive edge over our rivals. Compare to other firms in China, we may be smaller, but we are certainly more efficient and cost-effective. We are able to make decisions more quickly than larger firms and provide our clients not only high quality service, but round-the-clock attention because of our global coverage. In addition to our offices in Shanghai and our base in Miami, we have a physical presence in Sao Paulo, Bogota, and Caracas. Our size also means our operational costs are lower and this translates to fee savings. We are extremely competitive on rates—and this is something that is vitally important to clients in a global economic downturn, our flexibility here is something that isn't only liked by our Fortune 500 clients but makes us accessible to SMEs as well.



Robert Lee, Diaz Reus