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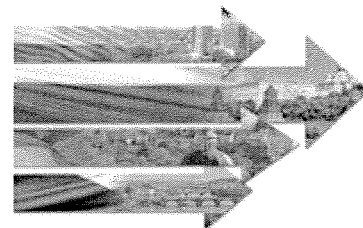
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Differences dissolved – the diminishing divide between local and global firms in CEE

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17 May 2013 | 00:00 |



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As Europe's legal systems become increasingly harmonised, distinctions between East and West and local and international firms are blurring. Mark Smulian reports

The differences are dissolving. When the Berlin Wall fell, Europe's western and eastern halves barely knew each other and doing business across this divide was problematic.

Today, eastern Europe's EU members have relatively harmonised legal systems and so offer a fairly predictable working environment. This marks them out from Russia and Ukraine, where English law is often preferred for governing contracts because of a lack of confidence in local systems.

But even there, the ways of doing business are becoming more 'normal' for foreign lawyers and clients. Recession hit this part of Europe, although, with lower debt levels than Western Europe, it has recovered – if from a low base – somewhat more rapidly.

Growing popularity

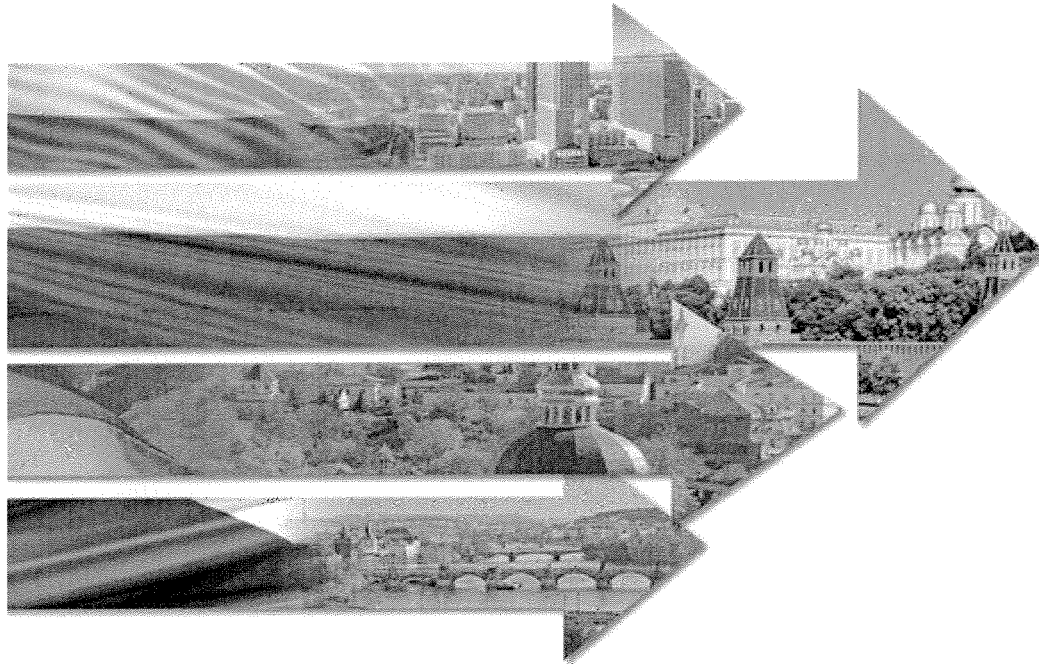
Though M&A remains subdued, dispute resolution is growing, in particular in Russia and its neighbours. One effect of the dissolving differences has been a relative decline in the position of once-dominant international firms. Today, there are thriving domestic rivals – often run by those who once worked for international firms – which compete by offering local knowledge and lower prices.

Moscow-based Freshfields Bruckhaus Deringer partner Sebastian Lawson (pictured, below) explains: "Local firms have expanded, and both local and international clients are increasingly content to use local firms, and their charges will be less too. International firms' financial structures mean they find it difficult to promote even

the very best local lawyers to their partnerships because the profitability is not high enough, so often they join local firms or set up their own."

Lawson says this trend has been particularly marked in the Baltic States, the Czech Republic and Hungary: "Russia is very different, and the legal market is dominated by international firms. There is still an emphasis there on English law governing contracts, even between Russian companies, because it gives greater certainty."

"That is partly down to a lack of faith in their own legal system and partly uncertainty over, for example, what a warranty means in Russian law."



Ondrej Peterka, managing partner of Prague-based Peterka & Partners, says the growth of local firms is part of "decision-making moving from west to east, to firms in Prague, Warsaw, Russia and other places".

He adds: "Certain international firms in Prague try to keep prices high, and I wonder if they will stay in the market."

Jan Kohout, a partner at Prague's PRK Partners, agrees: "Things are quite cost-sensitive and clients feel that international firms are not really giving them what they need."

Others think clients will take a pragmatic view. Winston & Strawn partner Costanza Russo says: "It's true in Eastern Europe that there are more domestic firms now and many have lawyers who trained abroad. But I find clients will normally want to use a domestic firm for local law but an international one for aspects outside."

Richard Clegg, head of Wolf Theiss' Sofia office, thinks there is no hard local/international split across the 13 countries in the region where the firm operates: "Clients look for better value and see better capacity than before in local firms, but both are doing pretty well."

Talking up chances

But Jason Mogg, managing partner of Kinstellar – the independent CEE firm spun out of Linklaters in 2008 – thinks there is some 'talking up' going on: "I think those who say that local firms are replacing international ones here probably work for local firms."

Mogg says the transaction market is noticeably changing, as historically 90% of regional transactions were western Europeans buying eastern assets.

According to him: "Westerners are trying to sell to raise money to fix whatever problems they have back home, but most of the money is still in western Europe so assets do not always fetch what is expected when they seek eastern European buyers. We see some activity by investors from the Middle East, China and North America, but they are still trying to understand the region so there is not a lot."

Mogg says transactions are picking up from the depths of the downturn, and arbitration and litigation is doing well, while "M&A is not absolutely dead".

One growth area is regulatory work and countering corruption. He says: "The UK Bribery Act and the US Foreign Corrupt Practices Act are forcing countries to clean up and improve. In some countries, corruption is really an issue. But things are improving because there is increased press exposure and the public are fed up with it, and that is driving real changes."



Mogg sees Eastern Europe's economies diverging: "The Czech Republic and Poland are increasingly integrated with the German economy, so people from Western Europe see something they understand and look to invest there."

"But others will find them a bit boring and want somewhere they can take higher risks and get higher returns, so might look to Romania and Bulgaria."

Things look promising across the whole region, he argues, because "legal work is very much driven by the economy and the fundamentals aren't so bad here, as debt is not as high as in Western Europe".

Clegg says: "We're still investing. Things are not like 2007, but we're benefiting from eastern European companies growing and becoming less reliant on foreign investors."

"There are now eastern European companies that can expand beyond their home market into the rest of the region, and engineering is growing with the automotive sector doing particularly well."

He thinks the country to watch is Turkey: "A very important investor in Eastern Europe and I could see great integration taking place between the Turkish and eastern Europe offices of international firms."

But, as Clegg concludes, Eastern Europe has no star market: "These countries are all different. There's no particular one I'd expect people to rush into."

Russia

The Russian legal market is vast, but it is dispute resolution and energy that win most attention, despite concerns about corruption hanging over dealings.

Oxana Balayan, managing partner of Hogan Lovells' Moscow office (pictured), says: "Regulatory matters, compliance, procurement law and Government contracts are increasingly important as the Russian state is a key market player in various industries and is quite frequently a contracting party."



"A lot of legal work now surrounds Government relations, as there is not historically the depth of a lobbying industry that you find in the US, for example. We have reacted to the change in increased demand for compliance and investigations work by recruiting a partner and three lawyers from Linklaters."

Balayan says corruption is an issue, but "not as bad as it was a few years ago with improved anti-corruption laws and training for judges and regulators, but there is still a way to go".

Despite these problems "the opportunities here are far too big for foreign companies to ignore", she says.

Russia is a hub for work in neighbouring countries where Russian is widely spoken and clients seek lawyers who understand the language, and so "a good piece of debt capital markets work for those countries is run from Moscow".

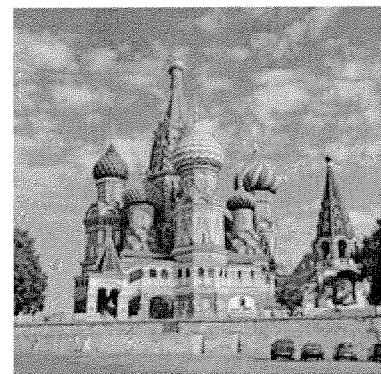
Winston & Strawn partner Andrei Yakovlev quite often finds himself 'out east' in Kazakhstan and Kyrgyzstan in disputes cases, including a notable one acting for Kyrgyzstan's Agency for Reorganisation of Banks and Debt Restructuring, which in April began action for \$63m (£40m) against former directors of Asia Universal Bank, who include three US senators.

"There are also disputes between oligarchs, and between companies and managers," he says. "Most of the contracts I see have an English governing law clause because it's seen as a stable legal system. I'd say about half of arbitration cases go to London."

Yakovlev describes Russia as "stable, but not a favourable environment in which to do business, as corruption and relationships with Government are issues".

"We have a Moscow office, but unlike some international firms I don't think we will expand greatly, we will have a few lawyers doing high value cases rather than 100 lawyers doing lower value work."

Freshfields' Moscow partner Sebastian Lawson says: "There is a huge amount of dispute resolution. Five years ago, it was 25% of our work. Now it is half."



Vassily Rudomino, senior partner at Moscow-based firm Alrud sees local practices such as his growing: "Historically, the international firms did much of the work we do, but more now comes to us. Clients are comfortable as they see a Russian firm and can get the same or better service as from an international one, and at a better price, and not all of them are happy with the international firms' rates." He notes IT as a major growth area.

Of all the industries, though, it is energy that makes Russia really big business. Norton Rose Moscow partner Nick Dingemans says: "Oil and gas are performing strongly and new legislation will only reinforce that."

Major changes to the civil code from March 2013 state that no party may benefit from 'bad faith' and establish how state registration of assets, real estate and intellectual property will be conducted.

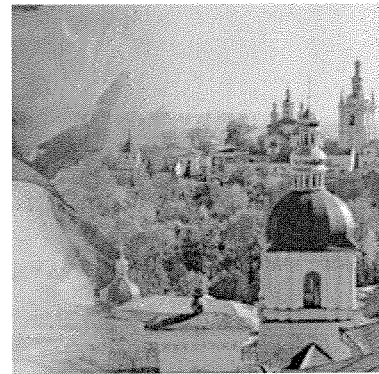
Later proposed changes will simplify forms of corporation introducing concepts such as option agreements and indemnity.

"All these are the necessary building blocks of structured financing and the project documents required for such financing," Dingemans says. "If implemented they would allow for true limited recourse financing of projects in Russia."

Ukraine

Ukraine is not in line for EU membership, but will benefit from a 'Deep and Comprehensive Free Trade Agreement' later this year, opening access to EU markets and investment.

Bertrand Barrier, head of the Kiev office of Gide Loyrette Nouel, says: "The legal market is currently quite stable, but there is limited work in the capital markets. Ukraine has a large agribusiness sector and in recent years prices have been high so there has been money to invest and agriculture has been a very active market. Natural resources and energy are also active, although the size of deals, except for shale gas, are medium."



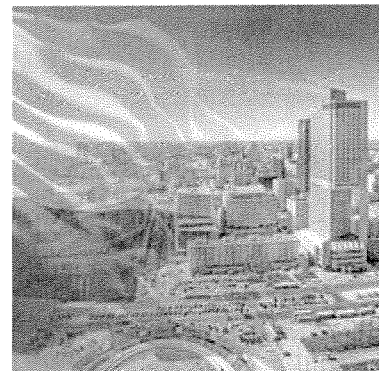
Contracts between Ukrainian parties must be under the country's laws, but not those involving foreigners. Barrier says: "We try to avoid using Ukrainian law and have contracts governed by French or English law if foreign companies are involved because of the uncertainty there can be over, for example, shareholder agreements, so clients will often want a foreign dispute and arbitration procedure."

Roman Marchenko, senior partner at Kiev's Ilyashev & Partners, says aviation and pharmaceuticals will be two growth areas: "Ukraine is one of few countries in which aircraft are designed and manufactured, and we work for the whole industry – which is fully state-owned – as well as with many airlines and airports."

Marchenko says that the pharmaceutical industry "is a core for us as it's growing quickly and reaching pre-crisis level in volume terms".

Poland

Poland provides an example of local firms challenging international ones. Regional practices took four of the top 10 positions by headcount in a survey by the newspaper Rzeczpospolita in March, the largest being Warsaw-based firm Domanski Zakrzewski Palinka. Judged by revenue, the local firms did even better, filling half of the top 10. The country escaped the worst of the recession, making it attractive to firms that lacked a presence. Wolf Theiss last year took on the Warsaw office of German firm Beiten Burkhardt. Partner Richard Clegg admits: "In Poland, we were late opening because the market was very well established."



Marcin Wystrychowski, a lawyer and consultant in professional services, explains: "Business-oriented lawyers in Poland do not feel any crisis. There has been a slowdown in M&A and project financing, but law firms can definitely reap benefits in the infrastructure and energy sectors. Other interesting sectors are food and retail, hospitality, natural resources and private client."

"There are fewer M&A and financing deals and the market is severely competitive, with most M&A handled by foreign firms or boutiques. There is a considerable slowdown in real estate and private equity."

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