



## FOREIGN LAW FIRMS RECALIBRATE CHINA STRATEGY AS ENVIRONMENT TOUGHENS

International law firms operating in China have been mired in a crisis of confidence following a series of grim news. In the latest signal of market dismay, Magic Circle firm Linklaters and Clifford Chance trimmed associate headcounts in China and Hong Kong as a result of the weaker economic environment.

At least 20 junior attorneys were cut at Linklaters, which branded the move as “modest reduction” in response to the “prolonged downturn in the China market”. Clifford Chance was said to have let go of around four associates, citing their failure to meet billing requirements.

The developments came just weeks after U.S. capital markets powerhouse Latham & Watkins shrunk its footprint in mainland China, leaving the only lights on at its Beijing office. Latham justified the closing of its Shanghai outpost as a result of the expiry of its lease. The decision also came when Beijing unleashed sprawling anti-espionage and stringent data protection regulations, seemingly compounding the deepening economic woes.

Peter Zeughauser, a legal analyst at Zeughauser Group, notes that Latham has had a “grow close or no grow” approach to Shanghai since launching an office there around two decades ago, and will continue to be driven by its own calculus in China.

“Their incredibly strong financial performance and their similarly strong international brand indicate that they

have consistently, across their platform, been interested in only the most important client work; work that merits their talent pool and for which they can command their fees. With presently diminished foreign direct investment in China and outbound China work, it’s easy to make a case for consolidating,” says Zeughauser.

A senior foreign lawyer based in Japan working in a large U.S. firm, who asked not to be named because of the sensitivity of the information, tells ALB that one of the reckonings that international firms increasingly have is that the vast Chinese market is not as big as it had seemed.

“There has been a misunderstanding on the parts of foreign firms entering China over the availability of the pie that is the Chinese legal market,” this Japan-based senior lawyer says. “The substantive and lucrative legal work comes from state-owned businesses. Most of China’s largest companies and the big money thereof are tied to the government. And that portion of work only goes to firms with direct government contact.”

They cite King, Wood & Mallesons as the most notable example of foreign firms thriving in both longevity and viability in China “not because they played around the system, but that they have become the system.”

“Western law firms need to think very carefully when they enter China and deploy their investment. Unfortunately,

most clients have not factored in the corporate governance situation in China regarding the selection of counsel,” they say.

In August, Dentons exited China after splitting with its China arm, Beijing-based Dacheng Law Offices. Dentons, the world’s biggest law firm by headcounts, attributed its retreat to the toughening regulatory environment. But the unnamed lawyer, who used to work in a U.S. firm in Shanghai, believes it’s a fundamentally a business decision.

“For Dentons, it’s a long-term strategic blunder to tie up with Dacheng in China as they keep on throwing money on that decision, and that money keeps on burning in light of the Sino-U.S. decoupling process and things they are seeing politically. Now they have an excuse to pull out at a time they are increasingly losing the ability to justify a holdout.”

Zeughauser highlights a bigger, common problem facing international firms in China at the moment, and that is the rise in sophistication of homegrown Chinese firms.

“The quality of the top Chinese firms has increased dramatically over the past two decades to the point that they can now out-compete the top international firms for work and talent in China,” he says. “The lack of attorney-client privilege and other incursions on the western legal practice regulatory norms continue to erode the effectiveness of and the interest in maintaining and growing a mainland practice for the vast majority of international firms.”

In Zeughauser’s view, the China market isn’t for everyone, so it’s quintessential for firms to chart their own China strategy, “for Chinese law firms that need best friend relationships, for Chinese clients that need lawyers in foreign jurisdictions, and for foreign clients desirous of penetrating and growing in the Chinese market,” he notes.

“The leading Chinese firms are spending time understanding and developing strategies for serving homegrown and foreign clients. Foreign law firms should be doing the same with respect to China. There is a lot of synergy to be had,” he adds. 