CEE change? How independent law firms are faring in the challenging Central and Eastern European market

Author: Dominic Carman | 27 Nov 2014 | 11:52 |

How can you make hay in the Central and Eastern European legal services market? As Dominic Carman finds out, it involves negotiating some fairly pitiful fee rates

Sandwiched between a turbulent Ukraine and a troublesome Russia to the east, and a troubled eurozone to the west, Central and Eastern European (CEE) countries are inevitably affected by the acute problems of these larger neighbours – the chief providers of their trade and investment.

Some fare better than others. Poland has been one of the fastest growing economies – a byword for stability in the CEE and, with 40 million citizens, the region's largest. It is also the only EU member state to avoid post-crisis recession.

"The Polish legal market was stronger in 2014, with continued interest from foreign investors," says Rudolf Ostrihansky at Soltysinski Kawecki & Szlezak, one of the country's big three independents, the others being Wardynski and Domanski Zakrzewski Palinka (DZP). "There are many players and very few new entrants, with strong mutual relations and non-violent competition between independent firms."

By assuming Salans, as part of its three-way merger last year, Dentons Warsaw became the largest local office with 170 lawyers. Among the magic circle, Allen & Overy (A&O) and Clifford Chance (CC) are deemed successful by local firms, Linklaters less so, with Weil Gotshal & Manges the most aggressive US-based player.
Tomasz Wardynski, founder of the firm that bears his name, highlights a continuing trend for spin-offs, like Kieszkowska Rutkowska Kolasinski, established in April by three former Baker & McKenzie partners.

DZP managing partner Krzysztof Zakrzewski points to fewer M&A transactions because of the Ukraine crisis, despite his firm closing eight deals, more than any other independent. Wardynski identifies increased interest in healthcare and hi-tech, while real estate deals, particularly by investment and private equity funds, are prominent, according to Ostrihansky and Zakrzewski.

All three highlight a significant increase in dispute resolution for which "clients do not use international firms", says Ostrihansky. "Independent firms are better suited to litigation because they're perceived by local judges as strong players."

Significant pressure on rates and fee structuring – caps, budgets, fixed fees, success fees – makes negotiating with clients "less pleasant", notes Zakrzewski. "Some international firms go in with very low rates, lower than us, which is surprising." Ostrihansky explains: "International firms are more eager to cut rates very deeply – to keep lawyers busy."

"Most firms keep prices down, but don't accept fees below cost: there must be some profit," adds Wardynski. "Although rates range from €180-€250 (£140-£200) an hour, firms work many more hours than they are charging." Ostrihansky suggests the average flat hourly rate is €120 (£96).

A&O remains in Warsaw, Prague and Budapest. Among CEE markets where they had offices, Poland is the only country that has not been abandoned by the other magic circle firms. Elsewhere, their legacy lives on: Kinstellar (an anagram of Linklaters, whose CEE offices the firm assumed in 2008) is the largest independent regional firm; in Budapest, Lakatos was spun off from CC in 2009.

"Setting out with four offices (Bratislava, Bucharest, Budapest and Prague) we've built them slowly but steadily, increasing revenue and profitability," says Lukas Sevcik, managing partner of Kinstellar's Czech operation and regional corporate practice head.

Following Belgrade, Istanbul and Almaty, Kinstellar's most recent opening, in November, was Sofia. "There's no plan to catch up with the largest domestic players in each market," adds Sevcik, though the firm is planning further additions, including Ukraine, when circumstances allow.

Describing the twin departures from Prague of Norton Rose Fulbright and Hogan Lovells in 2014 as "a seasonal development", he argues that local rates are "simply inadequate" for international firms.

In common with independents across the region, Sevcik highlights a substantial increase in work triggered by the US Foreign Corrupt Practices Act, and especially by the newer UK Bribery Act: compliance, investigations, data protection and white collar crime. "Foreign companies operating in CEE are aware of certain practices by their subsidiaries, which are putting them globally, or in their home countries, under extreme pressure in terms of investigation or criminal liability," he explains. Internal investigations for corruption or unfair market behaviour embrace many sectors, notably pharmaceuticals, hi-tech and automotive.

"Hungary had a good story and an even better perception; now we have a worse story and a much worse perception," says Lakatos founding partner Richard Lock. "The country is being punished for the disappointment factor."

Lakatos advises "an almost entirely international" client base, with a focus on investors restructuring or exiting the economy and suing the government. Pressure on fees "is not so relevant in the kinds of work we do", says Lock.

There were 45 foreign firms in Hungary in 1994, mostly riding the wave of privatisations. "The pendulum has swung massively in the other direction," comments Lock. He suggests that much of the work now undertaken by key international players – Weil, White & Case and Bakers, acting for government entities or state-owned enterprises – is not very well paid.

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White & Case, which retains one of the strongest regional footprints, closed its Bucharest office in January, forming an alliance with local firm Bondoc: a further symptom of the problems facing international firms trying to make their CEE operations pay.

Plummeting fees

So is life therefore easier for leading independents? In July Musat advised Electrica, Romania's major electricity distribution company on its €444m (£349m) listing, the country's largest ever initial public offering. Managing partner George Musat believes that Standard & Poor's decision, in May, to restore Romania's investment grade "has put the country on private equity funds' radar", making him more optimistic about 2015.

But Romanian independents have yet to feel the benefit. In 2013 rates were sometimes as low as €20 (£16) per hour. "The problem is worse than last year; it's going down month by month," says Musat. "Trying to make a name, engaging in dumping activities, medium-sized firms in the top 20 are cutting rates lower and lower. We don't understand how they can do it. It's unfair competition. We resist these practices and don't believe they are sustainable."

Nestor partner Adriana Gaspar agrees: "Price prevails over quality everywhere in this market and in much of Eastern Europe: small and medium-sized firms with aggressive marketing offer fees at incredibly low rates. It takes time for clients to feel the negative effects: eventually lower rates translate into lower-quality services. It's unethical competition. The credibility of the profession in Romania is affected."

At Bulgaria's Boyanov, founding partner Borislav Boyanov is equally gloomy. "If somebody asks about the crisis in Bulgaria, we say 'which crisis?' because we are always in crisis here. Clients squeeze us for fees; local players and international firms cut rates."

He offers a prominent example: "We were asked to advise Gazprom. After long negotiations, it reached a level where we were supposed to work for €12 per hour. Meanwhile, my friends at Freshfields Bruckhaus Deringer tell me how Gazprom pays them €1,200 (£960) per hour in Moscow."

How low do rates go? "You will not believe me," says Katarina Cechova, senior partner at Cechova in Slovakia. "In public procurement for a state agency, for significant legal work local firms were offering themselves at €2 per hour. I was speechless."

Although less extreme, other accounts of savage rate-cutting, intensive client pressure and severe competition proliferate.

While Poland may be better placed, law firms in many CEE countries are praying not just for an improved global economy, which will, in turn, drive demand for legal services and may increase fee rates, but also for national governments that make foreign investment easier and more attractive. Without them, many CEE independents face a difficult future.

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