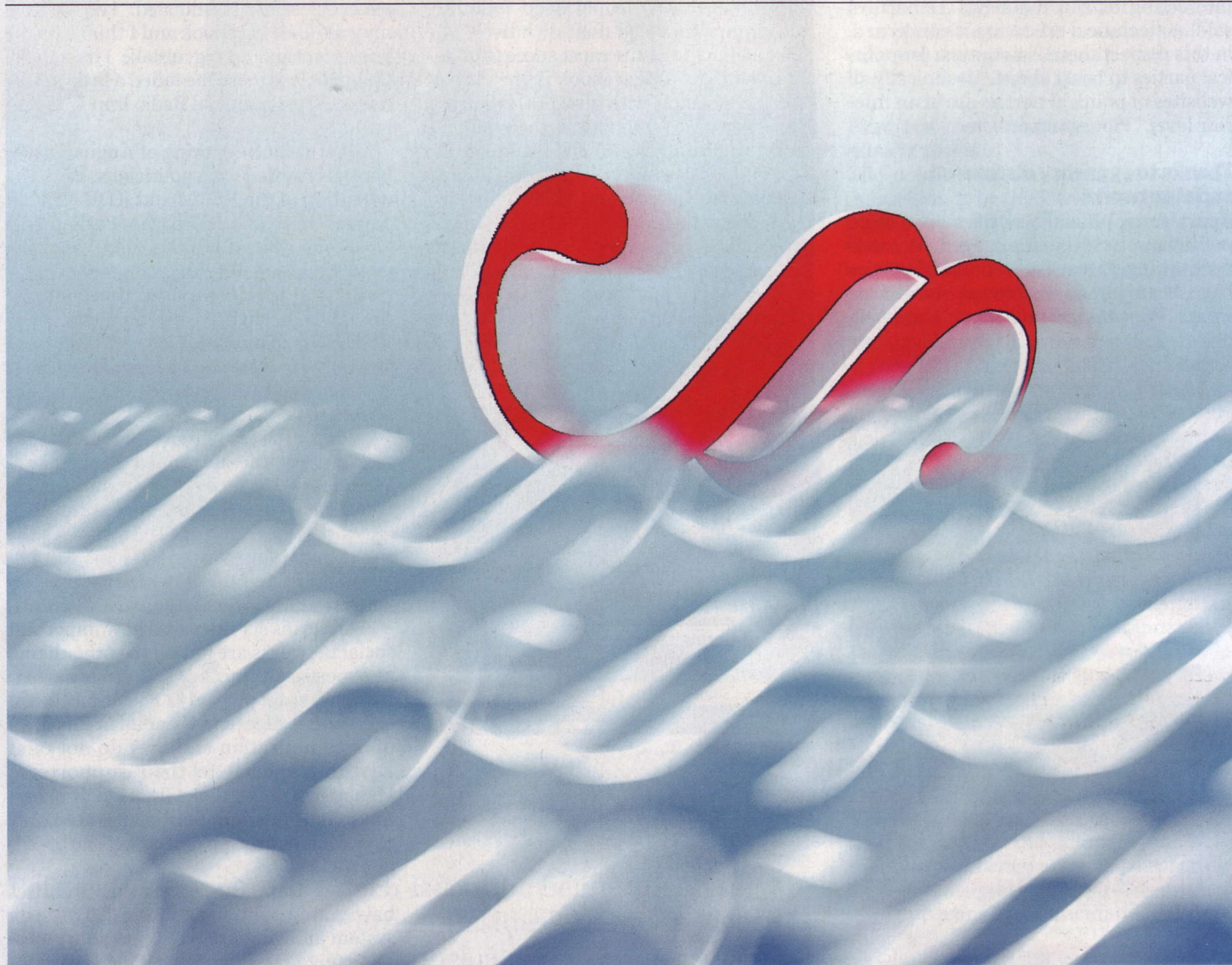


# THE STORY



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## How to enjoy swimming in **stormy legal waters**

Confronted with the most severe economic downturn in the recent history of the country, Czech law firms learn to swim their way out of the crisis, carefully balancing customers' requirements for cheaper, yet higher quality legal services. And those who adapt quickly seem to be already enjoying the benefits, as revenues keep pouring into a more consolidated and specialized Czech legal market.



Czech-based law firms didn't have an easy year in 2008. After an inflated optimism driven by privatizations and big real estate, finance and corporate deals, their options seemed to shrink all of a sudden, watered down by a global economy that is the worst since the Great Depression that began in 1929. Now, law firms must provide quality guidance—and not only for their customers, but for their own survival as well.

The key seems to lie in specialization. Even though the Czech legal market saw two major exits in 2008—the British Magic Circle firm **Linklaters** and Germany's **Gleiss Lutz**—newcomers such as the British firm **Bird & Bird** show that there is still potential in Central and Eastern Europe (CEE), when used properly.

Bird & Bird entered the Czech legal market in late autumn last year. Its practice is now based on two pillars. The first is traditional legal advisory such as corporate mergers and acquisitions (M&A), and consumer and labor law. The second and most important is intellectual property and Internet technology (IP & IT). “This is where we'd like to see ourselves growing, for this is where the potential of this market lies,” Tomáš Novák, head of the Prague-based nine-lawyer office of Bird & Bird, told *CBW*. Novák, an M&A and corporate specialist, joined Bird & Bird in Prague from **Clifford Chance**. Simultaneously with the Czech Republic, Bird & Bird opened three more offices in Poland, Slovakia and Hungary, thus covering the whole CE. The decision was a means to consolidate the firm's rising international position. “One reason was [that] we were following our clients into this region. The second was a question of boosting our profile in the whole [CE] region where we see certain opportunities in the IT practice,” Novák said. “The whole world is changing. Yet, it is still an encouraging place and a whole set of new opportunities is being opened [with the crisis],” he said. “We believe in the CE's potential.”

Last year, Bird & Bird had a breakthrough year, mainly driven by its IP, technology and media operations. The firm saw revenues up 29 percent to £186.3 million (Kč 5.6 billion/€218.4 million), putting the firm into the UK top 20 for the first time and “heralding a commanding pan-European position in its chosen markets,” according to the legal news server *LegalWeek.com*. Thus, the firm climbed six slots, from the 21st to the 15th largest law firm in the UK by revenue.

Meanwhile, it also added 214 staff members and grew lawyer count by 28 percent, adding 153. This was a contrast to

most top 50 rivals, as the firm secured two mergers—with 30-lawyer UK practice Lane & Partners and Finnish firm Fennica—and opened six international offices in 2008.

And this wasn't the sole push for bigger numbers on the Czech market. British law firm **Eversheds'** Czech ally **Balcar Polanský Eversheds** launched a new office in Ostrava, North Moravia, its second office in the Czech Republic. Eversheds' international network covers 43 offices across 26 countries. Also, domestic law firm **Havel & Holásek** (H&H) is aiming to boost its Slovak presence by taking in a local firm through a merger (*see box, page 20*). Czech law firm **Kocián Šolc Balaščík** (KŠB) opened a new full-service branch firm in Ostrava in March 2009.



Kamil Blažek

#### Catching up

Now in Prague, Bird & Bird isn't the only firm trying to catch up with those already established on the Czech markets. Last year, while Bird & Bird was preparing its CEE entry, another top UK-based international law firm, **Linklaters**, was exiting Prague and its Southern and Eastern European offices in Budapest, Bratislava and Bucharest. Its successor, the regional law firm **Kinstellar** also seems keen on specialization. It has recently brought in David Cantor, a top-ranked European Union communications lawyer on the position of “of-counsel.” “This illustrates David's expertise in a domain where we'd like to increase our presence. There are a lot of deals in telecommunication in CEE that we'd like to be more involved in,” said Kamil Blažek, a partner with the Prague-based office of Kinstellar.

Kinstellar, which kept a headcount of 100 people despite a slight downsizing of its Prague operations that was balanced by growth in the Bucharest team, has recently enhanced its operations in the Balkans. In February 2009, it set up a team of lawyers that are now active in Serbia, also covering Montenegro and the rest of former Yugoslavia. This team is now getting ready to set up a full Kinstellar office for the Balkan region. “It's a matter of months till we open it up,” Blažek said. Asked if the opening means the beginning of Kinstellar's push for an increasing presence in the Balkans, he said that this European region is too small for being covered with larger operations. “In the past, we used to cover ex-Yugoslavia from Bucharest only. We believe that our Serbian office will manage incoming deals. For the future, Ukraine and Turkey represent much more interesting markets for us,” he said.

#### Downsizing expectations

Even though newly open, Bird & Bird had to adapt their income expectations to the realities of the Czech market. “We actually have cut our expectations by some 15 to 20 percent,” Novák said. This was caused by the level of initial investments and a high pressure on legal fees. According to *LegalWeek.com*, the spectrum of anticipated reduction in the level of hourly fee rates across Europe in 2009 ranges from 10 to 25 percent.

“The payment moral deteriorated for the last 12 months on the Czech market overall,” Blažek said, declining to reveal concrete expectations for Kinstellar revenues in 2009. “We thought it wiser not to release any forecast. We do have a budget, but the current market conditions are very difficult to read, so we wanted to avoid hazardous comments. We believe we'll have a better overview for 2010,” he said.

“Market conditions are indeed more challenging,” said Daniel Weinhold, managing partner at **Weinhold Legal** in Prague. “I have just spoken to one of our long-term clients who is known for extensive usage of top-class external consultants in numerous areas. All their advisers had to accept much lower fee rates compared with last year. It is not easy to remain competitive and maintain good results, and a lot of effort is necessary,” he said, adding that, in general, much more effort is needed to maintain good results. Yet, the main characteristics remain the same: “good market offerings, precision in all elements of work and clever billing strategies are crucial for success,” he said.

#### The bottom is still to come

However, the market conditions still prove challenging. Josef Vejmelka, a partner with local law firm **Vejmelka & Wün-** ➤



# THE STORY

**sch**, said that the impact of the economic downturn on the Czech legal market is not yet so dramatic. Still, in the second half of this year the situation may become worse for many firms, since the crisis' effects will appear on the market with a certain delay. "Many [clients] have survived the first part of 2009 quite successfully mainly because of a successful year 2008, but they will be confronted with the downturn in the upcoming months," he said. This is because when cutting costs, external counsels are one of the first victims, unless the firm's problems are burning and need to be resolved immediately. "It's like when you have a health problem. You will want the best doctor with the relevant experience and the price alone is not the most important criterion on choosing one. The same applies to companies and financial institutions affected by the current economic environment," said David Plch, partner of U.S.-based **White & Case** office in Prague and head of its banking and financial restructuring and insolvency practice.

Vejmelka added that, as always, there will be some winners and losers in the end. "The former will likely be practitioners in insolvency proceedings, restructuring and debt recovery, while the latter will be those previously proud of their mergers and acquisitions, finance or real estate projects," he said.

More legal market participants agree that Czech law firms that offer a broader range of services and very good restructuring, insolvency and dispute resolution practice groups are doing very well. Ondřej Peterka, a partner with domestic law firm



Tomáš Novák

**Peterka & Partners** in Prague said that large multinational law firms that provide services at high hourly rates have been weakened. "Clients no longer want to pay only for a big name. This is a fundamental change. Also, Czech law firms with niche specializations in real estate law have been affected by the economic crisis," he said.

"It's actually a bit unfortunate what's going on," Blažek said, describing how often customers ask for large fee discounts. Moreover, when going to a tender, some law firms are so desperate to get the job that they come up with discounts up to 50 per-

cent from the fair value of the contract. This is also happening in tax and auditing advisory, he said. "Such firms might win a job or two, but this isn't sustainable in the long term. Besides, it affects the market and it's also toxic for clients because they won't be able to properly evaluate the fair price of services and build accurate expectations for the future," he said.

Another aspect Blažek emphasized was that, as the focus has been changing toward the restructuring business, the costs for law firms are increasing. Thus, while for a merger deal a large team of lawyers was necessary, but it could include cheaper junior

## H&H plans merger, aims to boost Slovak operations

One of the growing domestic law firms, **Havel & Holásek (H&H)**, is in discussions with several Slovak partners for a merger. Thus, the firm would boost its local operations and enhance its presence, Jaroslav Havel, a founding partner with H&H told *CBW*.

H&H is currently in merger discussions with several Slovak law firms, but Havel wouldn't disclose their names. The merger is expected to take place in a matter of months. The size of the firm will be up to 10 lawyers. H&H's main focus will remain the Czech and Slovak market. The firm would continue to operate under the H&H brand and could operate as a joint-venture. The Slovak arm would be fully integrated and run by the H&H executive committee. "This would make us a real Czechoslovak law firm," Havel said.

"Because it's a smaller market, Slovakia is also more difficult to penetrate," Michael Mullen, a partner with H&H commented on the merger. "It's easier for us to merge with someone than to grow our firm there," he said.

The Slovak market has been more influenced by the Austrian model, so stronger German language knowledge is necessary there, Mullen said. One of the advantages will be the expertise on euro adoption that could be brought to the Czech Republic in the next decade.

H&H has currently almost 200 employees in four offices in Prague; Ostrava, North Moravia; Brno, South Moravia; and Bratislava, Slovakia; two years ago they had less than 90. In 2008, H&H worked on about 1,300 cases for more than 500 clients, revenues reached more than Kč 200 million (€7.7 million).

### New challenges for new times

Havel said that, even though the firm has expected some slight drops in real estate and financing lines, the firm has been continuing to operate at decent levels in all lines of business. "We don't have one or two clients to pull an entire team—we have several clients. Thus, diversification has been very helpful for us," Mullen said. He said that, four years ago, H&H was a young law firm that had been just beginning its work. Now, it's automatically included on the list of major tenders. "We aren't changing so much; it's not us moving toward the market, but it's rather the market moving to us," he said.

Mullen said that the firm is now more careful about accepting clients. "It's not that we weren't careful before. It's rather that we recognize that some clients may not be able to pay in the end," Mullen said. Another argument is that the firm goes for a long-term cooperation approach and accepts only those cases where that is envisaged.

"We are also very careful to avoid potential conflicts of interests," Havel said. Almost every second case of call for ad-



lawyers who would do the job in two to three weeks, restructuring takes much longer and involved senior, more expensive lawyers. "You can do it with a team of four lawyers, but three of them must be experienced. They are more expensive, as they're doing a more complex job. So, law firms must take all these aspects into account when they're building their revenue projections," he noted.

### Trying to stay afloat

Despite such challenges, lawyers have apparently learned fast to adapt. "Although the market conditions differ from the best times when significant transactional activities were bringing huge volumes to all leading law firms, we predict solid, stable results," Weinhold said. Also, Vejmelka said that the first six months of 2009 were even better than the same in 2008, which was excellent. "My expectations for the short- and mid-term are still positive, as we are involved in several restructuring projects where our clients are contractually obliged to pledge the assets in favor of their creditors, to transfer the shares within their groups, while others use the current situation for their expansion. On the other hand, we understand that new business may go rather to other countries than to the Czech Republic in 2009. Nonetheless, our revenues will hopefully reach the optimistic budget," he said.

At Peterka & Partners, expectations are a bit gloomier. "In 2009, we expect a 5 to 10 percent decrease in turnover compared with 2008. However, we do not expect a decrease in the Czech Republic. The



Martin Siebert

decrease in the group is mainly due to a decrease in turnover in Ukraine," Peterka said.

Miroslav Dubovsky, managing partner of the British law firm **Lovells** in Prague said that since the last quarter, they have received several distressed asset sale mandates through their international network and they are also acting on a number of pending solvent restructurings over Czech assets. "There are several worldwide clients of the firm that are currently seeking new markets to enter, including the Czech Republic. This is all rather encouraging for the legal market, as against the rather bleak backdrop at the beginning of the year," he

said, mentioning that Lovells' dispute practice is also still going strong, including some recent successes for petrochemical firm **PKN Orlen** in defending multiple arbitrations brought against it by food and chemical conglomerate **Agrofert Holding**.

Dubovsky noted that the Czech legal market has certainly changed over the most recent months for more counter-cyclical types of work, such as dispute resolution and restructuring. At the same time, there has been no change at all to the somewhat depressed leveraged finance market since the last quarter. "We do not anticipate that this will be any different for the foreseeable future. The pricing of assets remains still highly uncertain even for the few cash buyers in the market. Without greater certainty over this, many willing buyers, and in some cases sellers, are prudently hanging on until they can be more certain of a better deal," he said.

Dubovsky noted that the credit crisis created a significant number of client opportunities. For example, Lovells advised the government of Iceland on a \$2.1 billion (Kč 37.9 billion) recapitalization of its banking sector, which may result in the control of two of the new banks created in the aftermath of the credit crisis last year in October. In continental Europe, Lovells also advised the German Federal Ministry of Finance in connection with the grant of stabilization measures by the German bank support fund (SoFFin) to **Commerzbank** in the framework of a capital increase and a further silent participation. "As far as our firm is concerned, there is a steady stream of work. We continue to win new clients, in Prague and globally, and many projects with existing clients also come to a completion. Overall, I would expect that to continue," he said. ➤



Courtesy of Havel & Holásek

visory brings such a risk and this must be evaluated properly.

In 2009, the overall turnover of H&H is expected to increase by some 10 to 25 percent on the year. Yet, the debt collection and litigation business will grow more, in hundreds of percents, Havel said. He added that salaries of partners on the

Czech market vary between €100,000 and €2 million per year, even though this is little, comparable with the Western markets. H&H charges between Kč 3,000 to Kč 4,000 per hour or more, depending on the difficulty of the assignment. This is in the below-middle range of the Czech market, Mullen said. ■



# THE STORY

"This crisis changed our work," Blažek said. While mergers and acquisitions (M&A) and real estate development and investment projects are down, the restructuring and insolvency work goes up. Yet, even this field growth doesn't reach initial levels expected in January 2009. As the crisis didn't yet fully hit the Czech Republic, more work will come in these sectors in the future, he argued.

## The agreement matters

Another change that the Czech legal market has been experiencing was emphasized by Vladimíra Papírník, managing partner of **Squire, Sanders & Dempsey**. She said that the long-term effect of the crisis is visible in the increased insistence on the quality of contractual documentation. "Businesspeople are already starting to realize that the agreement matters. It's not enough to have a business deal with your partner—you need to document it well," she said. This is because when times are hard and business partners are unable to deliver, they are looking for loopholes and ways out from the black and white text of the deal documentation. "This is more so today with the personnel changes in managements of the firms; today it is hard to face your partner and argue that 'we both know what we meant by this clause' as the one who negotiated and signed the agreement may not be in the position anymore," she said. Thus, despite the potential short-term pressure on creative billing, including caps or structures similar to success fees, even the Czech business world "will learn the lesson hard that spending your money on your lawyer can prevent major problems and costs in the future," she said. Also, a short-term effect she emphasized was that clients appreciate more a trusted adviser than solely a legal technician. "They will value lawyers who can help them make the client relationship more efficient. It is the lawyer who is often better suited to advise the client how to push down expenses on lawyers with as small effect on quality as possible for example by suggesting what work can be done internally by the client or by preparing standard forms on repetitive standard tasks and involving the counsel on extraordinary or more sophisticated matters," she said.

White & Case's Plch said that clients always sought in their lawyers the ability to provide top-quality practical advice on time and for a fair price. "In good times, the complex provisions of legal documents were rarely tested in practice and business deals were consummated without any disputes. The current economic environment and financial difficulties of some companies naturally create much more friction among the parties of increasingly complex commercial relationships. These circumstances for the first time test in practice the



Michael Mullen

Jakub Stadler

quality of the documents drafted in the good times," he said. Moreover, good legal advice may now, more than before, make a real difference in terms of the financial outcome for clients. "We see many situations in which a timely legal action protected significant value for businesses. On the other hand, we are also sorry to see many situations where a company or a financial institution failed to optimize its legal position and defend its legal rights in time, which resulted in dramatic financial losses," he said.

## Transparency over finance legal kitchen remains low

On a complex market, it's not easy to measure the ups and downs of individual companies, as very few legal firms publish full financial accounts. "It would be great if the crisis would stimulate more transparency," said Jaroslav Vaško, chairman of the supervisory board of the Czech legal news server Epravo.cz. Even though it's hard to evaluate the hit of the crisis on law firms in the absence of concrete revenue figures, he said that troubles could be expected at firms with a too-narrow business focus. The outcome would be either their disappearance from the market or the slimming of their operations.

Regarding the matter of transparency, lawyers say that full disclosure is met on the Anglo-Saxon markets, where it's used as a marketing tool to attract talents. "Legal business, even in the case of large firms such as ours, is still to a great extent private business. We are not politicians or listed companies accountable to their shareholders where the appeal for transparency or need of improvement would be fully appropriate," Weinhold said. Besides, incomparable figures mixing together remuneration for one's own legal advisory with channeling cost of other ad-

visers, provision of nonlegal services such as tax services or lobbying "would say nothing anyway," he said.

"I believe the reason [for a low transparency] is that we are in the Czech Republic. You need a lot of time to explain to people that success and high incomes do not always mean that you must be a crook. Unfortunately, many of the rainmakers you may read about are indeed not angels. I presume that things will definitely improve in the future, but it will take time, my guess is 10 or more years," Papírník said. *SV*

"There is a certain pressure from media for more disclosure, but I think it'll take some more time before this happens," said Michael Mullen, a partner with H&H. How much time—this is more difficult to guess.

## Will they grow?

An article issued by the LegalWeek.com at the end of 2008 stated that smaller international law firms have an excellent potential to take advantage of the new market conditions in order to expand abroad. This would fit with the strategy of numerous Czech law firms that decided to head mainly east during the last decade.

"I believe that Czech law firms will continue to expand abroad, mainly in the CEE. Eastern Europe is suitable for expansion by large Czech law firms. Reasons for this include language, cultural proximity and the continuing expansion of Czech companies into the region. On the other hand, I do not think that the market in the Czech Republic will consolidate in terms of mergers and acquisitions among law firms. There is no room for it. The market is too small and the risk of conflict of interest too high. However, I cannot rule out mergers or acquisitions entirely. There may always be individual transactions of this type," Peterka said.



"I guess everybody is opportunistic and if there is a good business case, for example, following a major client abroad or merging with synergy effects, there will be such developments," Weinhold said. "Yet, I doubt that a significant systematic foreign expansion makes much business sense. How many, for instance, Portuguese or Danish law firms operate in other jurisdictions? Are they less clever or entrepreneurial than Czechs? I don't think so," he argued.

"Czech firms will continue to expand abroad, but such expansion will in my opinion not bring the deserved results from a long-term perspective. I am rather skeptical in this respect, since foreign markets will rather be dominated by truly international law firms in a global sense and, at the same time, by several domestic law firms," Vejmelka said. "I do not want to underestimate Czech firms in this respect and I admire their courage to establish their presence abroad; nevertheless, their role on foreign markets is of a marketing potential rather than a real long-term business," he said.

Peterka added that the crisis has also its benefits, as some taboos are broken. "Some lawyers (associates) previously refused to work for Czech law firms, since they were not prestigious enough. Also, some clients preferred foreign law firms. Now, real quality and fair prices are most decisive," he said. This all plays well for large Czech law firms. "I predict that the Czech market will be similar to the Austrian one in the near future. There will not be so many multinational law firms present. Instead, more large regional or medium-size local Czech firms will be seen," he said.

#### Where does the potential lie?

Papirnik said that, on the short-term, the demand for legal services in insolvency, litigation and labor law will grow, while on the longer-term the demand will reach renewable energy and the public sector. "The energy and infrastructure will grow same as with the advisory business in competition, public procurement and contract law. Companies are now more worried; they invest more in lawyers and they advise in early stages, more than done a year ago," Blažek said.

Public-private partnerships (PPP) are finally catching on as well. Experts claim that CEE continues to hold great potential for projects. In the Czech Republic, although PPP legislation has been in place since 2006, there has been no real PPP project yet. LegalWeek.com noted that 10 projects, mainly relating to transportation and highways, have been announced but there has been no real adherence to schedule and so far all have continued to be wholly government-funded instead. The most topical project in the Czech Republic right



Letiště Praha's privatization is expected to keep Czech lawyers busy in the future.

now is the privatization of Prague Ruzyně Airport operator **Letiště Praha**. The other main projects making headlines are the expressway to Southern Bohemia and Austria and the connection between Prague and Ruzyně Airport, both intended to be financed by PPPs.

Moreover, the new insolvency legislation adopted in 2008 keeps Czech lawyers busy. "My expectations for short- and mid-term developments for Czech law firms are positive in general, but not applying to all firms equally. The largest firms will have to restructure their current

Czech operations with regard to the profitability in certain areas that became less profitable and, at the same time, to further elaborate on the areas that might represent their core business in the future. In addition, the trend will obviously be to organize and manage the law firms in a way similar to that of the clients," Vejmelka said. He added that new areas of interest will appear within the next three years, allowing some law firms to focus on these new areas of practice. The revenues will be closely linked with the success of the business development and with the global market situation. Smaller firms and sole practitioners are more flexible, but may have difficulties in attracting major clients, not speaking about those who will fight to survive, he said.

Petr Kasík, a partner with KŠB, said that the challenges faced by the financial markets, which were key actors in the creation of the financial crisis, have generated a lot of associated work as a result of these challenges faced by financial institutions. There are also other industry sectors that continue to organically grow, largely independent on the financial crisis, for example, the alternative energy sector—solar and wind energy—in which there is strong client demand. "It should be noted that our views are based on our experience as a large law firm. It is evident that for small boutique law firms who have specialized only in a certain narrow area of law, the economic downturn can have very serious implications," he said. Because the financial crisis may yet take some unanticipated twists and turns, currently the best way for law firms to prepare themselves for the uncharted path ahead is "to be ready to offer clients a fully comprehensive spectrum of legal services so that clients' changing needs can be fully met at the necessary time," he concluded. ■

## Lessons learned from the crisis

**Lessons for law firms:** diversification is key (having diverse portfolio of clients from various business fields will mitigate the downturn in the work flow for the firm). Also, investment into young people (junior associates) pays off—smart and trained young associates can do a lot of quality work at lower rates (unless downgraded to form-fill-in clerks for the first couple of years of their legal practice).

**Lessons for young lawyers:** with more quality people on the legal job market, especially the young lawyers will appreciate having a job. And their salary expectations will be more realistic (and aligned with the expectations of the law firm).

**Message to the clients:** bring your lawyer into the problem at an early stage when more strategies are still available. Involving your lawyer during such "brainstorming" sessions won't cost much and can save you lots of money.

Source: Vladimíra Papirnik, Squire, Sanders & Dempsey