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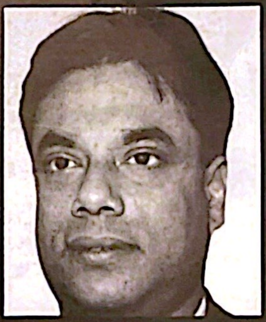
THE GROWING POWER OF EUROPE'S IN-HOUSE COUNSEL

DUTCH FIRMS LIMIT LIABILITY

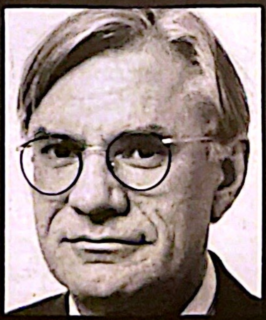
Are Warsaw's legal pioneers poised to profit?

M&A and capital markets work is booming
Witold Danilowicz, White & Case

'Long-term prospects remain sound'
Nick Fletcher, Clifford Chance



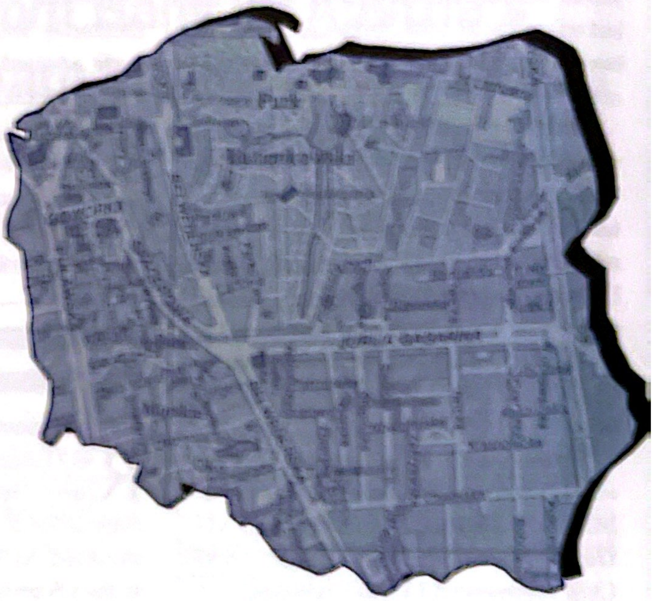
'Polish companies now embrace international law firms'
Duleep Aluwihare, Arthur Andersen



Working to keep the market open for foreign law firms
Roman Rewald, Weil, Gotshal & Manges

ENVIRONMENTAL LAW – IN SEARCH OF A CLEANER, GREENER EUROPE DEWEY BALLANTINE BOOSTS HEADCOUNT IN UK AND HUNGARY **M&A BOOM HITS DUBLIN** ALLEN & OVERY BAGS POLISH SECURITIES REGULATOR **MAJOR GERMAN INCOME TAX REFORMS** SHEARMAN HANDS BATON TO BUDAPEST TEAM **READY, STET, GO... FOR ITALIAN TELECOMS SALE** STIKEMAN, ELLIOTT SETS ASIAN GOALS **EVERSHEDS TO ADVISE LITHUANIA** NEW SWISS TAX TREATIES

Pole stars



Poland is one of the most exciting legal markets in central and Eastern Europe. But it may become closed to further expansion from western law firms. Nigel Page and Richard Marsland investigate.

Like the other former Soviet-bloc economies, Poland has been in economic transition throughout the 1990s, turning a centrally planned, rigidly state-controlled system into a market economy more closely resembling its counterparts in western Europe. The country's resulting need for foreign direct investment, and for the western financial and legal expertise necessary to sustain and regulate the capital inflows, has created a thriving market for legal services in Warsaw, the Polish capital and financial centre. And it is a market in which a number of international firms have established a firm foothold.

A combination of economic and regulatory factors mean that the provision of legal services in Warsaw is largely a sellers' market. Generally, there is plenty of work to go round, little need for discounting of hourly rates, and – so far at least – only a limited amount of fixed-fee work undertaken. At the same time, there is deep uncertainty over whether more foreign law firms will be allowed to enter the marketplace. Those international firms which have already set up offices in Poland therefore feel they have got 'under the wire,' and are anticipating being in a strong position as further deregulation opens up industries such as power and road-building.

However, the future regulatory position remains unclear and continues to be the subject of sustained lobbying, both from a predominantly protectionist local profession, and from an international law firm contingent understandably keen to protect its market position.

Growth and promise

In comparison with its regional neighbours, Poland's greatest asset as an investment market is its sheer size. Its population of around 39m people dwarfs other central and eastern European economies, such as Hungary and the Czech Republic (both 10.3m), Bulgaria (8.4m) and even Romania (22.6m). As well as being large, the population is relatively well-educated and has a strong business and entrepreneurial tradition.

The country covers about the same geographical area as France and lies in a strategic position between western Europe, the Baltics, and the former Soviet Union – leading many corporations to choose Poland as a base from which to cover the central European region. Poland's longer-term attractiveness is further enhanced by the fact that it is expected to gain EU membership within the next decade.

The economic background is also promising. GDP growth for 1996 was around 5 per cent, and is expected to be marginally higher than that for 1997. The government's budget deficit is running at around 2.8 per cent of GDP – nominally within the EU's Maastricht criteria for economic convergence. However, inflation in 1996 remained over 20 per cent, and rising consumer demand coupled with slowing exports have seen the country suffer from a growing trade deficit. Fixed investment growth is expected to show a short-term slowdown in 1997 during the run-up to the parliamentary elections in September.

This generally positive economic background, together with Poland's increasing openness to foreign ownership and well-established privatisation programme, has seen it attract US$12bn in foreign direct investment since the fall of communism in 1989. The Polish government is planning to attract a further US$18bn by the end of the decade, an aim which suggests that fears over the political commitment to greater foreign investment may prove unfounded.

Lawyers in Warsaw have noted a change in the profile of the foreign investment into Poland. Nick Fletcher, who heads the Clifford Chance office in Warsaw, says: 'To start with, the major international players were looking at start-up ventures here, and also at picking up some of the early ventures that were being privatised. But now, more of the foreign investors are looking at buying home-grown enterprises here, where the Polish entrepreneurs have successfully developed their own business. Also, foreign investment into Poland has meant that foreign companies now have assets of some significance here – so Poland is therefore becoming significant on a strategic, Europe-wide basis, when companies come to look at refocusing or restructuring their business.'

Fletcher adds that even if fears of a slowdown in the privatisation programme are realised, the fundamentals mean that long-term prospects for work in Poland remain sound. 'At the moment, foreign investment and domestic economic growth have developed almost in spite of what the government has or hasn't done,' he says.

'The pace of reform and privatisation has been slower here than in some of the other central European countries,' Fletcher continues. 'But despite that, the fundamentals have meant that privatisation and economic growth have progressed. And there is now a framework and a pattern in place that will allow Poland to go forward, and continue to attract international investment.'

Capital ideas

The investment flows seen so far into Poland have been led by multinational companies in two sectors: fast-moving consumer goods (FMCG) and the automotive industry. Leading multinationals such as Nestlé, Proctor & Gamble, Cadbury and Unilever are major investors in Poland, in common with motor manufacturers including Ford, General Motors and Daewoo. With giants such as these successfully established, increasing numbers of medium-sized companies across the EU are starting to look at Poland as an investment base. This process is being encouraged by the continuation of deregulation and privatisation.

Fletcher, Clifford Chance: home-grown

A further sign of Poland's progress towards a market economy is its fledgling but thriving capital markets. There are currently 80 stocks quoted on the Warsaw exchange, with the market governed by a regulatory body explicitly modelled on the US's SEC. Plans are also afoot for a regulated and standardised market in futures and options. Interestingly, popular enthusiasm for privatisation and deregulation is considerable, with the latest round of Poland's mass-privatisation programme in November 1996 attracting queues the like of which had not been seen since the Soviet era – but this time for privatisation certificates rather than bread.

Over 500 Polish companies are included in the 'National Investment Programme,' and will ultimately be sold off by Poland's 15 National Investment Funds. Many of these have already been restructured and are available for full or partial privatisation. Details of a further few thousand state-owned companies are available from the investment information department of the Polish Treasury. And Poland's flagship corporations – such as the copper producer KGHM Polska Miedz and LOT Polish Airlines – are included in the capital privatisation programme, which the government hopes will bring it a budget windfall of around US$1bn during the course of 1997.

This economic background continues to bring law firms in Warsaw considerable opportunities in inward investment, M&A, general commercial, IP and capital markets work. Project finance is expected to take off during 1997 as the power and road construction sectors are increasingly deregulated, while continuing privatisation (if the political will is as strong as the government claims) and growing use of bond and debt finance should further raise the amount and quality of capital markets work.

Aluwihare, Arthur Andersen: easy acceptance

Cultural revolution

But as well as the growth in particular areas of work, law firms are also benefiting from a cultural change, under which the old communist practice of using in-house advisers is breaking down, with the newly-commercial corporations turning to outside professionals.

Krzysztof Ziebinski, commercial director of LOT, which is advised by the Warsaw office of the US firm Hunton & Williams, believes that the quality of legal advice available in Warsaw has had to rise quickly to keep pace with the rapid economic development. 'The standard has improved very much, because leading law firms now have their Warsaw offices, and they employ Polish lawyers with a vast knowledge of Polish law and international law,' he says. 'These firms are getting better and better. And this also brings a change into the Polish economy, because previously every company used its own in-house legal department, but now more and more companies are using outside law firms.'

Duleep Aluwihare, managing partner of Arthur Andersen in Warsaw, also notes a change. 'Particularly in capital raising and privatisation, there is now very easy acceptance by Polish companies of taking on international law firms,' he says. 'Three years ago this was not the case –

and it was the foreign investor or the government which brought the international law firm in.'

This change of attitude has seen around twenty international law practices set up offices in Warsaw, with a fair mix of US, English and other European firms. Legislative requirements have meant that their vehicle of entry has had to be a limited liability company (denoted in Poland by SP z o o). Foreign-qualified lawyers cannot advise on domestic Polish law, so young, high-quality local lawyers are very much in demand.

Local partnerships have unlimited liability, but since the international firms came in as limited liability companies, their liability is limited to their initial capital – often a few thousand zlotys.

Poles apart

While the international law firms tend to dominate international corporate and commercial legal work, two local firms are frequently cited as being on a par with the leading foreign practices – Soltysinski, Kawecki & Szlezak, and Wardynski & Partners. Both these firms have made a virtue of being Polish. Professor Stanislaw Soltysinski, one of five partners in the 28-lawyer firm Soltysinski, Kawecki & Szlezak, says: 'We have had many proposals to merge or be acquired by multinationals. But we have decided to remain Polish, because we think there is a fairly large niche for high-quality legal services offered by Polish lawyers who are also familiar with the Anglo-American and western European legal systems.' He adds that many multinational corporations prefer to use a local firm – and points to a client list including Microsoft and Goodyear as evidence.

Professor Wardynski's firm is the largest in Warsaw with around 50 lawyers. Some 80 per cent of Wardynski's client base is international. Daewoo, for instance, selected the firm to advise its landmark investment into Poland, the acquisition of local manufacturer FSO. But Professor Wardynski looks ahead to a future in which the local market rises in importance: 'The Polish domestic client market holds out enormous potential for us. At present most corporates here still have traditional in-house departments (especially the banks). But that situation will change as more lawyers leave to set up their own firms and this will create more opportunities for Polish lawyers, with the top Polish corporates going to the top Polish law firms.'

There is also an increasingly strong tier of younger law firms looking to challenge the Wardynski/Soltysinski duopoly, while offering a western-style service to international clients.

Furtek Palinka Zielinski is one such, formed from the former in-house legal department at Bank Handlowy and well regarded in Warsaw. Another is Beata Gessel i Wspolnicy Sp zoo – this was started in 1993 and focuses principally on M&A (privatisation, antitrust and tax). As name partner Beata Gessel (formerly head of Arthur Andersen's legal department and Weil, Gotshal & Manges) points out, her firm has been growing at 100 per cent each year.

Although the firm is as yet not well known outside of Warsaw, it has an enviable client base and is clearly looking to challenge not just the local scene, but also the international firms based there. At present, the bulk of the client base is American – due in part to Dorothy Hansberry's presence as partner (formerly of the US Department of Justice) – with a strong background in funds, including the Polish American Enterprise Fund and the Polish Private Equity Funds (1 and 2).

A further example of a well-regarded Polish firm is M Lukowicz i Partnerzy, which has a good track record in govern-

Leading law firms in Warsaw

Allen & Overy	Kancelaria Prawnicza
Altheimer & Gray	Maciej Lukowicz i Partnerzy
Amhurst Brown Colombotti	McKenna & Co Sp. z o.o.
Baker & McKenzie	Nabarro Nathanson
Beata Gessel & Partners	O+R+S Adwokaci
Cameron McKenna	Ole Nielsen & Partners
Clifford Chance	Pünder, Volhard, Weber & Axster
Dewey Ballantine	Salans Hertzfeld & Heilbronn
Furtek Palinka Zielinski	Soltysinski Kawecki & Szlezak
Gide Loyrette Nouel Polska	Trenite van Doorne
Hogan & Hartson	Wardynski & Partners
Hunton & Williams	Weil, Gotshal & Manges
Jeantet & Associés	White & Case

This list does not purport to be exhaustive ment privatisation work, as well as in inward investment and joint ventures for foreign-owned multinationals. Sole partner Maciej Lukowicz, who has advised on the Polish ventures of firms such as McDonalds and Michelin, says: 'It is now very difficult to divide foreign and Polish clients. If a Chicago-based company sets up a 100-per cent owned subsidiary here in Warsaw, is it Polish or foreign? Really, because it's Polish-incorporated, it's Polish.'

Another strong local firm reflects the cultural/business links connecting Poland and Germany – O+R+S is a hybrid Polish/German firm concentrating on business activity between the two countries and comprising two German and two Polish lawyers. Its prime market is small to medium-sized German companies, along with the high level of Polish construction work west of the border in Germany. Polish partner Konrad Kielczewski says: 'Our main competition is with the other English speaking firms in Warsaw – there are still not that many German firms here. Our real advantage is linguistic; we need to be able to interpret between the lines.'

Sole concerns

However, the majority of the local legal profession – which continues to be dominated by sole practitioners – is less sanguine about the competitive threat from foreign law firms. One leading Polish lawyer reckoned he spent about 15 per cent of his time sorting out mistakes made by foreign lawyers, who had been 'over-confident' in applying legal principles learnt in their home jurisdiction.

Robert Dewar, a commercial partner with Hunton & Williams in Warsaw, is not surprised by such a claim. 'In the grand picture of things, concepts of commercial finance do translate fairly well into Poland,' he says. 'But in terms of minutiae and practical aspects, that is not the case. If you take the attitude that you have done this lots of times in the US or UK, and therefore you know what you are doing, then you can very quickly go wrong. You have to get the Polish lawyers to handle it.'

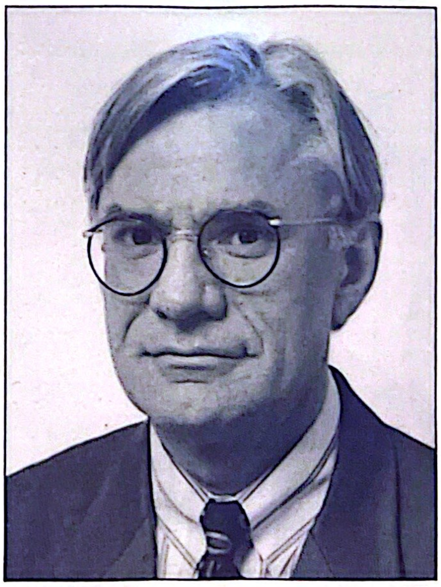
The local profession has, of course, been alarmed by the incursion of the major foreign firms. One Polish partner in a local practice, who declined to be named, says there are several reasons for Polish firms' claims that the competitive playing-field has not been level – and for their desire for tighter restrictions on international firms. Local legal partnerships have unlimited liability, but the fact that international firms came in as limited liability companies means that their liability is limited to the level of their initial capital – often the minimum of a few thousand zlotys required under Polish law.

Also, under the commercial code which applied in the early 1990s, many international firms setting up limited liability companies enjoyed a tax holiday during their first three years in Poland. Local firms feel that the international firms' financial strength has given them a head-start in terms of premises, computer equipment and staffing. 'It means that they can pay more then is necessary under Polish circumstances,' complains the local lawyer. 'They have distorted the employment market.'

Restrictive practices

Not surprisingly, given the strength of feeling in some parts of the local profession, the Polish government is contemplating a tightening of the restrictions on foreign firms entering Poland. The likely outcome is hard to predict – initially it was expected that those firms in place in Warsaw prior to 1 October 1996 would be grandfathered (that is, exempt from any new restrictions).

However, at the time of writing in mid-January, the government appeared likely to discard the grandfathering proposals lobbied for by international firms. At Weil, Gotshal & Manges, Roman Rewald has been closely involved in the informal lawyers' grouping committed to sorting out this position. He argues that the current situation has grown out of the Soviet era's split profession and that initiatives to resolve that position risked alienating foreign firms in Warsaw.



Rewald, Weil, Gotshal & Manges: no more or less

Rewald maintains: 'There is as yet no law prohibiting the unauthorised practice of law in Poland. Foreign lawyers here want to keep the existing position, whereby they can practise Polish law through and with the support of Polish lawyers. We are keen to allow all newcomers to obtain the ability to practise foreign international law, or Polish law through Polish lawyers employed by, or partners in, their firms. We are asking for no more or less than a Polish lawyer would expect to get in London or New York.' But as another locally-based international lawyer puts it: 'There are ways around this position if it goes against us – that is why we are lawyers, to solve problems.'

'Foreign lawyers here want to keep the existing position, whereby they can practise Polish law through and with the support of Polish lawyers… as a Polish lawyer would in London or New York.'

The real effect will most likely be to make it much tougher (if not impossible) for any new international firm to enter the market. As the managing partner of one Warsaw-based foreign firm laughs: 'It will become very hard for new foreign firms to come in other than by forming an association with a Polish firm. And now that the local Polish firms are beginning to make serious money, any prospective new entrant would need to wave a very fat cheque book indeed.'

Windmill, McKenna & Co: bidding aggressively

Picking up power

This is, naturally, good news for those major players which have built up reputations there – but will prove frustrating to onlookers once the expected weight of project financings comes on stream. White & Case, Clifford Chance, Allen & Overy, Weil, Gotshal & Manges and Baker & McKenzie are amongst the lead international firms in town, and they are confident that the market will, for them, continue to prove fertile.

At White & Case, managing partner Witold Danilowicz points out that the firm has built up an extremely strong profile in M&A and capital markets, handling all bar one of the international issues from Polish issuers, along with the major Philip Morris acquisition of a local cigarette manufacturer (big business in one of the world's chain-smoking capitals).

Baker & McKenzie enjoys an excellent reputation in Warsaw and is certainly one of the largest practices (with 35 lawyers) – even larger since acquiring the well regarded Dickinson, Wright, Moon, Van Dusen & Freeman practice last year. Lead partner Jur Gruszczynski points to privatisation as a key area for the firm from the start (Baker & McKenzie opened in 1992) and clients have included Phillips, AT&T and Pilkington. Gruszczynski anticipates a marked increase in project activity – the firm has been instructed by Autostrada Wiekopolska, one of the bidders for a new highway project – and goes on to say: 'A new energy law should be approved and in place [this] year, which will open new opportunities for foreign investment in this area. It should kickstart the power sector, which is in need of restructuring, and BOT structures are likely to prove popular.' With Westinghouse as a past client in Poland, Baker & McKenzie is looking to pick up work in this sector.

It should be said that if the power sector really does pick up, specialist power project outfits should be expected to set up some sort of base in Poland (even under the most restrictive practice regulations) and Chadbourne & Parke, Vinson & Elkins, and Skadden Arps Slate Meagher & Flom must all be contenders. Gruszczynski also points to an area of capital markets activity likely to gather pace in the coming year: the issuance of municipal bonds (the firm advised on the Gdansk bond issuance).

Accounting for taste

A development with further implications for the legal market is the presence of the major global accountancy firms, which have acquired considerable legal expertise and which see a steady flow of staff between themselves and the law firms. Most of the Big Six run combined tax and legal departments, while Coopers & Lybrand has its own in-house licensed Polish law firm, which C&L partner Antoni Reczek claims has several multinational clients not serviced by the firm's audit side. Two years ago, this operation was comprehensively raided by the Warsaw office of McKenna & Co, but has since been rebuilt. Reczek says clients are positively happy to have both functions handled within C&L: 'It's significantly safer and more efficient for the client than having the two separate entities,' he claims.

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In terms of billing, most legal work is still conducted on an hourly basis, with firms attempting to resist pressure to guarantee fixed fees in advance. They are helped in this by the relatively large amount of work on offer, meaning low-balling and beauty parades remain relatively rare. However, as cross-border capital markets work grows, firms are beginning to bow to pressure in this area to provide quotes in advance.

Fixed-fee arrangements are also relatively common in company formation work and in due diligence ahead of a privatisation or acquisition, with the fee estimated on a sliding scale depending on the size of the business and the number of sites it occupies.

The healthy state of the legal market has also meant most leading firms have built up a good track record in bread-and-butter inward investment, M&A, privatisation, joint ventures, and general commercial work.

But some have established particular niche expertise. Dewey Ballantine has a strong entertainment practice, much of which it inherited from a former tie-up in Warsaw with Theodore Goddard. Amhurst Brown, whose Warsaw office is run by two Polish partners, is acknowledged as a market leader in drawing up prospectuses for listings on the Warsaw Stock Exchange.

Salans Hertzfeld & Heilbronn Sp z o o is amongst the front-runners for IP and telecoms advice – the firm is principal counsel to Coca Cola on trade marks in Poland and has advised AT&T on structural issues in the Polish market. And McKenna & Co (under Robert Windmill), as well as handling a fair proportion of Poland's early capital markets work, has built up a pre-eminent real estate and construction practice – especially since acquiring a heavyweight real estate team from Nabarro Nathanson's Warsaw office. Indeed, the firm is regarded as bidding aggressively for local profile and should be expected to continue in its attempts to expand in Warsaw.

Such moves are likely to become more common as the market becomes more competitive and niche expertise realises more of a premium. O