LIBERALIZATION OF LEGAL SERVICES—EMBRACING A WORLD OF OPPORTUNITIES IN THE ASEAN REGION

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Asia has transformed into a fast-growing region and for it as an economic bloc to compete for trade and investments on the global platform, there is a need for it to embrace liberalization. Liberalization of a country is the key factor in attracting foreign direct investments. However, in Asia, the process of liberalization looks to be slow and gradual with restrictions to certain sectors such as the legal sector. The paper proposes to add to the debate on the need for local lawyers to accept liberalization within their highly protected legal sector. It describes the definition of liberalization and the positive changes it could bring to the legal industry. The paper includes a look into the global shift in economic order towards Asia, the increasing rate of international law firms’ expansion in Asia, the importance in liberalization, challenges faced by the legal firms, lessons learnt from experience of other liberalized jurisdictions such as China, and the vast opportunities which exist for the commercial lawyers in South East Asia.

INTRODUCTION.......................................................................................................................... 142
I. SHIFT IN THE CENTER OF GRAVITY OF GLOBAL ECONOMIC ORDER TOWARDS A RESURGENT ASIA ................................................................. 142
II. EXPANSION OF INTERNATIONAL LAW FIRMS IN ASIA............................................ 144
III. IMPORTANCE OF LIBERALIZATION IN THE SERVICE SECTOR AND THE CHALLENGES FACED WITHIN THE LEGAL SECTOR ....................................... 145
IV. URGENT NEED FOR LIBERALIZATION AND LESSONS FROM THE CHINESE LEGAL MARKET ....................................................................................... 146
V. A WORLD OF OPPORTUNITIES FOR COMMERCIAL LAWYERS IN SOUTH EAST ASIA......................................................................................... 149
CONCLUSION............................................................................................................................. 151

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INTRODUCTION

Over the next half century, the balance of economic power is expected to shift dramatically, with Asia transforming into a fast-growing region. In order to compete for trade and investments on the global platform, there is a need for Asia to embrace liberalization as liberalization is the key factor in attracting foreign direct investments. However, the process of liberalization in Asia is taking a comparatively long time with restrictions to certain sectors such as the legal sector. For the legal sector, there is constant debate on the need for local lawyers to accept liberalization.

With liberalization coming into force, we can expect to see more competition in work as Asia law firms are facing the biggest challenge by dealing with the prospect of opening up their highly protected markets to foreign lawyers. Over the years, we have witness many of the international law firms shifting their interest into Asia market. The questions remain as to how the local lawyers should react to these changes and how to seize this as an opportunity, turning it into something beneficial to them instead.

To help answer these questions, the authors focus on the importance of liberalization and identify the types of challenges faced within the legal sector liberalization should come into place. To tackle these challenges, the authors describe the need for harmonization and how Association of Southeast Asian Nations (ASEAN) countries can adopt common standards and agreed criteria for legal practitioners by member countries’ to practice law in the region.

In addition, the authors propose the need to draw lessons from the experience of other liberalized jurisdictions such as China. The authors describe how China dealt with liberalization when it was first introduced, followed by a look into the positive outcome of liberalization that has transformed China.

The article includes five parts: Part I offers an introduction to the shift of global economic order towards a resurgent Asia; Part II describes the expansion of international law firms in Asia; Part III elaborates on the importance of liberalization in the service sector and the challenges faced within the legal sector; Part IV analyzes the urgent need for liberalization and includes lessons learnt from experience of other liberalized jurisdictions such as China; Part V highlights the vast opportunities for commercial lawyers in South East Asia.

I. SHIFT IN THE CENTER OF GRAVITY OF GLOBAL ECONOMIC ORDER TOWARDS A RESURGENT ASIA

Legal services do not exist in a vacuum. In reality, the fate of the legal
industry is intractably linked to the wider economic and business environment of which it is a part.

In Europe and also in the United States (US), many international law firms are facing pressures on their businesses from a contraction in the demand for legal services as a direct result of the Eurozone debt crisis and the US deficit. The markets in Europe are showing little sign of any meaningful recovery. Clients are exerting pressure against increases in the billing rates of law firms. At the same time, the law firms face inflationary pressures on their cost base, including staff remuneration and a more complex regulatory and competitive business environment. As the level of transactional activity remains low, suppressed by weak and volatile economic conditions around the world, many international firms need to look at options to expand their revenue and maintain profitability. Many are seeking refuge in the emerging markets including Asia.

We are in the midst of witnessing the balance of global economic power shifting back towards Asia at a speed and on a scale never before seen. To quote Mohamed A. El-Erian, Chief Executive Officer (CEO) and co-CIO (Chief Investment Officer) of global investment management firm, Pacific Investment Management Company (PIMCO) and author of *When Markets Collide*:

> A new economic order is taking shape before our eyes, and it is one that includes accelerated convergence between the old Western powers and the emerging world’s major new players. But the forces driving this convergence have little to do with what generations of economists envisaged when they pointed out the inadequacy of the old order; and these forces’ implications may be equally unsettling…In an amazing turn of events, virtually every Western country must now worry about its credit ratings, while quite a few emerging economies continue to climb the ratings ladder…¹

This observation seems to be supported by recent reports and developments. For example, according to a recent report by Boston Consulting Group Global Wealth 2012 Report, “…by 2016, the Asia-Pacific region (ex Japan) should be wealthier than both Western and Eastern Europe combined…”² Also, in July 2012, Indonesia agreed to commit USD1 billion as capital to the International Monetary Fund (IMF).³ Contrast this with the situation after the Asian financial crisis in 1998-1999 when Indonesia had to take huge loans from the IMF to support its economy. McKinsey &

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³ Hatta Confirms Indonesia’s Loan 1 Billion USD to IMF, REPUBLIKA ONLINE (Jul. 2012).
Company, in a report issued earlier this month has predicted that by 2030 Indonesia will overtake Germany and the United Kingdom (UK) to become the world’s seventh largest economy.⁴

II. EXPANSION OF INTERNATIONAL LAW FIRMS IN ASIA

International law firms are taking the cue from their clients—Multinational Corporations (MNCs), the US and European corporations are increasingly expanding their investments into Asia. The rapid and sustained growth of trade and investment flows into Asia in recent years has been accompanied by an explosion of interest in merger, alliances or other combinations between law firms around the world. Between 2010 and 2011, law firm merger activity increased 65%⁵. The number of law firm mergers outside the US, jumped to 54 in 2011, as compared to 44 and 48 in 2010 and 2009, respectively.⁶ Fourteen law firm mergers and acquisitions were announced in the US during the first 3 months of 2012.⁷ Almost all of the major law firm combinations over the past year have expansion into Asia in their sights.

In the PricewaterhouseCoopers (PwC) Law Firms’ Survey 2011⁸ of the UK legal sector, they found that the appetite for merger appears to be high, especially for mid-tier firms. 70% (2010: 83%) of Top 11-25 firms and 53% (2010: 53%) of Top 26-50 firms believe a merger is very likely or fairly likely in the next two to three years. All Top 10 firms see a merger with a non-UK based law firms as their likely course of action. Most Top 11-25 firms, 58% expect to merge with a non-UK based law firm, whilst 70% of Top 26-50 firms expect to merge with a UK based law firm.

The expansion by international firms into Asia is reshaping the legal landscape, in a fundamental manner, in many countries in the region. Australia provides a striking illustration of the rapid and dramatic changes in the legal profession over a period of 2 years.

Today, the group of hitherto acknowledged leading Australian law firms of Mallesons, Freehills, Allens and Blakes no longer exist as before. Merger mania kicked off nearly two years ago with the arrival of Norton Rose who merged with Deacons. Then in 2011 DLA Piper merged with the Australian firm Phillips Fox. Since mid-May 2011 the international invasion

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has been unprecedented. Clifford Chance merged with two small boutique firms in Sydney and Perth. Allen and Overy raided a number of partners from the Australian law firm Clayton Utz and Squire Sanders poached the Perth office of Minter Ellison. In 2012, Ashurst merged with Australian law firm Blake Dawson Waldron. Blakes is now known as Ashurst. The merger between Freehills with British-based firm Herbert Smith created a global giant with 460 partners, 2366 lawyers, 23 offices around the world and an estimated US$1.35 billion in gross revenues—more than double what Freehills earned before the merger. One of Australia’s most prestigious law firm Allens Arthur Robinson recently established an Asian alliance with Linklaters. However, in terms of echoing the shift in economic power and illustrating the rising influence of China, the combination between Mallesons (by revenue Australia’s largest law firm) and King & Wood, a leading Chinese law firm has created the most ripples. Some may say that the King &Wood Mallesons represents the first real emergence of an Asia Pacific law firm in the global legal market.

III. IMPORTANCE OF LIBERALIZATION IN THE SERVICE SECTOR AND THE CHALLENGES FACED WITHIN THE LEGAL SECTOR

As the global economic power shifts towards Asia, liberalization of the services sector is essential in attracting Foreign Direct Investment (FDI) and promoting the sharing of knowledge. The growth of borderless markets and cross-border trade has changed the scope and character of services to an international scale. Institutional connectivity, of which services liberalization is a key driver, is necessary to facilitate any successful development and execution of transactions by the private sector. ASEAN has long recognized the importance of having a common framework for liberalization of key services such as transport (shipping, aviation and logistics), banking, accounting and legal practices. Individually, each member state has neither the software nor the hardware to compete against the powerhouse economies of China, India and Australia. However, as a single entity with a combined population of 600 million people and a combined nominal Gross Domestic Product (GDP) of more than US$2.1 trillion,9 ASEAN has a strong hand to compete if investors perceive the region as a collective force.

Under the ASEAN Framework of Services (AFAS) in 1995, member countries undertook commitments to liberalize their services by substantially eliminating restrictions to trade in services and worked towards

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9 IMF, World Economic Outlook (October 2012 Database).
developing a common services framework. Seven sectors were selected for services liberalization, including business services, which cover legal services. ASEAN legal markets must be liberalized to capitalize on the rise of Asian economies. Unfortunately, unlike technical and transport services, the rhetoric to open up the legal services sector has not been matched in reality with little progress so far. While five ASEAN countries—Cambodia, Indonesia, Malaysia, Thailand and Vietnam—have pledged “assurance” on legal services, these are not fully transparent and are tied up with many conditions or restrictions.

Moreover, the liberalization of legal services faces a number of unique structural impediments, which hinder integration within the region. Within ASEAN, each member country is governed by a different legal and constitutional system. For instance, Malaysia and Singapore are both governed by common law principles, whereas Cambodia and Indonesia follow the French civil code and the Roman-Dutch civil system respectively. Furthermore, law students are not taught the basic principles on how to bridge the differences. It is ironic that law students in Malaysia and Singapore, in order to gain their law degrees from the UK, are more familiar with the European Union laws than ASEAN laws. Qualification requirements also pose a barrier to export and trade in legal services, especially for the practice of host country law.

Legal education differs from country to country, which in turn results in a disparity of skill between each member country. In most instances the differences are so significant that regulators require foreign qualified lawyers to re-qualify in order to be able to practice. National treatment limitation is another significant barrier. This includes but is not limited to restrictions on partnership with local professionals such as equity restrictions, restrictions on the use of international and foreign firm names and residency requirements.

Another major challenge is that the legal sector in ASEAN faces inward looking and exclusive regulation by national professional bodies among many member states. As of yet, there has been no significant driving force to effect any forms of real liberalization. Local lawyers are reluctant to give up their monopoly on lucrative legal services and are apprehensive at the thought of having to compete with well-resourced international law firms if the legal market is opened up.

IV. URGENT NEED FOR LIBERALIZATION AND LESSONS FROM THE CHINESE LEGAL MARKET

It is imperative to achieve balance between preserving distinctive
national legal structures with the need for more harmonization and institutionalization in useful and common areas. This can be done by establishing common qualification entrance for ASEAN lawyers to practice in any member countries to facilitate freedom of movement if liberalization of legal services is to progress.

Another method is to look at the standards of practicing law in the ASEAN region given the lack in understanding of both common law and civil systems in member countries of ASEAN. There is a need to adopt common standards and agreed criteria for legal practitioners by member countries’ to practice law in the ASEAN region. In addition, legal regulations can play an important role by tracking and consistently monitor the progress in economic cooperation within ASEAN countries.

It is also crucial to adopt a building block approach to harmonizing our laws and focus on areas where there is a common agenda namely, facilitating economic cooperation, investments in the region and e-commerce linkages intra-ASEAN. Finally, there is an urgent need to encourage greater networking, more mutual understanding and knowledge-pooling amongst the stakeholders in the legal industry in the ASEAN region.

In contemplating the future landscape of the legal profession in ASEAN countries, it is instructive to learn some useful lessons from the experience of other jurisdictions. If properly managed, the process of liberalization can benefit the legal profession in a country.

China for instance, adopted a progressive approach to liberalize the legal market over a period of 20 years, with further liberalization and mutual future cooperation expected in the future. Foreign law firms are not allowed to practice local law, but have been licensed to practice in specific areas which facilitates the flow of investments and transactions by MNCs into China. Domestic firms are allowed to form collaborations, strategic alliances and other arrangements with leading international firms to facilitate knowledge sharing and best practices.

Today, China has managed to attract leading international firms to expand and provide value add services to MNCs and Chinese corporations. In 2011, liberalization of its legal services led to 208 licensed foreign firms establishing representative offices in China and became part of the US$116 billion FDI that flowed into the country. As the Chinese corporations embark on expansion globally, the local firms have also expanded their footprint and are exporting their services. Liberalization brought in a wave

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of foreign competition, but also strengthened trade and investment flows which have benefited local law firms.

It is important for China and ASEAN nations to work together to promote development and peace within the region as both are located in a rapidly growing Asian region. According to a statement given at the ASEAN-China Summit, the Chinese nation is ASEAN’s largest trading partner since 2009, while ASEAN has now become China’s third largest trading partner. The statement also indicated that the bilateral trade between ASEAN and China has increased by 20.9% from US$232 billion in 2010 to US$280.4 billion in 2011. In addition, FDI from China to ASEAN has also shown positive growth, increasing from US$2.7 billion in 2010 to US$5.9 billion in the following year.\textsuperscript{11}

In 2010, the China-ASEAN Free Trade Area (CAFTA) was launched. It is the world’s largest FTA zone of developing countries, covering a total population of 1.9 billion. Under the CAFTA, more than 7,000 products are now traded duty-free between China and the six developed ASEAN economies—Brunei, Indonesia, the Philippines, Malaysia, Singapore and Thailand. The other four ASEAN members—Vietnam, Laos, Cambodia and Myanmar—are to join the zero-tariff arrangement by 2015.\textsuperscript{12} Besides that, both parties recently also welcomed Hong Kong’s desire to join the free trade agreement. As China’s domestic consumption and investment grow stronger, there is demand for the country to import more goods from ASEAN countries. It is no surprise that the governments of both sides continue to sign more bilateral agreements to expand and deepening economic and trade cooperation.

For the legal services sector, transformation is required to adapt to the new regional trade landscape. The CAFTA would only be possible with the liberalization of laws and regulations that governed the legal profession. Hence, the liberalization of CAFTA legal services will be an important step forward. China has a successful model for regulating liberalization of legal services for ASEAN countries. This proves that the claims in liberalization of legal services will strengthen trade and investment flows into a country are not entirely without merit. With that, local firms in ASEAN region must be proactive to capitalize on opportunities from liberalized market or risk being marginalized by international firms.

\textsuperscript{11} ASEAN-Malaysia National Secretariat, Chairman’s Statement of the 15th ASEAN-China Summit (Phnom Penh, Cambodia, Nov. 2012).

\textsuperscript{12} China-ASEAN Trade Pact Starting to Pay Dividends but More Cooperation Is Needed, BANGKOK POST (Sept. 2012).
ASEAN countries have signed on to achieve the goal of an ASEAN Economic Community (AEC) by 31 December 2015,\textsuperscript{13} which is just less than 3 years away. The AEC aims to create a single market of goods, services and investment, facilitated by the freer movement of business persons, talents and labor in a region with its combined population and GDP of 600 million and US$2.1 trillion, respectively. With the AEC, we can expect to see increased economic integration and regional linkages amongst the ASEAN countries. More significantly, under the AEC, member countries of ASEAN have committed to liberalization of goods and services. This includes liberalizing of seven services sectors including Business Services—legal services are part of Business Services. In reality, there are likely to be tremendous challenges and issues in fully liberalizing legal services in the region.

Nevertheless, the strong political commitment to the AEC means that it is not a question of if, but when integration of economic activities in the ASEAN region happens, if not by 2015, not long after. Already we are seeing other sectors such as financial and technical services moving closer towards integration. Last year, we saw the roll out of the ASEAN Exchanges trading link which connects trading amongst Bursa Malaysia, Singapore Exchange (SGX) and the Stock Exchange of Thailand. The 3 markets offer investors easier access to more than 2,200 listed companies with a market capitalization of US$1.4 trillion, which accounts for nearly 70 per cent of the total market capitalization of ASEAN.\textsuperscript{14}

Secondly, over the past few years, we have seen the emergence of ASEAN regional banks. These were created by leading domestic banks in Malaysia and Singapore acquiring banks or stakes in other countries in South East Asia. Banks such as Development Bank of Singapore (DBS), Maybank and Commerce International Merchant Bank (CIMB) enjoy strong balance sheets, have less leverage and are flushed with liquidity so are well placed to expand at a time when their counterparts from the US and Europe are downsizing their operations globally. Indeed, earlier last year in a deal described as “audacious” by the industry, CIMB acquired Edinburgh-based Royal Bank of Scotland’s (RBS’s) investment banking and cash equities businesses in the region. Under the deal, it was reported that CIMB will have an additional 130 employees in Hong Kong, as well as 125 in Australia,

\textsuperscript{13} ASEAN Secretariat, \textit{AEC 2015 Remains on Track and Top Priority} (Sept. 2012).
60 in India, and 20 in New York and London.\textsuperscript{15}

Thirdly, we are in the midst of a dynamic region which continues to enjoy healthy economic growth and attract trade and investment flows. The ASEAN region is regarded as the “darling of investors” and a “safe heaven” by global investment funds faced with increasingly volatile markets in Europe and the US. By contrast, the equity markets in South East Asia are expected to generate more sustainable and predictable returns as companies in the region continue to grow. Malaysia already has the world’s second and third biggest initial public offerings in 2012 involving Felda Global Ventures Holdings Bhd and Integrated Healthcare Holdings Bhd.\textsuperscript{16}

Finally, sovereign wealth funds and companies in South East Asia are now engaging in more outbound deals and undertaking major acquisitions, intra-ASEAN and around the world. To quote a recent Wall Street Journal (WSJ) report, South East Asian companies are “…beginning to show their claws and have flexed their deal making muscles…”\textsuperscript{17} The WSJ reported that cross-border acquisitions announced by companies in the South East Asia region (excluding purchases by the region sovereign wealth funds), reached a record of US$29.9 billion as of August 2012, which is almost tripled US$11 billion at the same time last year. The brew battle in Singapore over Asia Pacific Breweries involved companies linked to Thai billionaire, Charoen Sirivadhanabhakdi, battling with Heineken, a major European MNC.\textsuperscript{18} Petroliam Nasional Bhd’s US$5.8 billion bid to acquire Canada’s Progress Energy Resources Corp and Genting Bhd’s bid in the United States to launch a US$4 billion casino resort at the Aqueduct Racetrack in Miami are major outbound deals by Malaysian conglomerates. Recently, Sime Darby Bhd, the world’s largest listed palm oil producer by acreage, and SP Setia Bhd teamed up to acquire Battersea Power Station, one of London’s most iconic landmarks, for US$620 million for a real-estate project that is expected to have a Gross Development Value (GDV) of £8 billion (US$12.55 billion) over a period of 15 years.\textsuperscript{19}

The foregoing examples amply demonstrate the new economic reality of active deal flows and transactions in South East Asia. It is likely, however, that for the time being, a major proportion of the work (and the fees) are still, handled by international law firms in the region who are usually credited as the lead law firms. These firms are usually able to take

\textsuperscript{15} CIMB SET TO TAKE ON GOLDMAN WITH “AUDACIOUS” RBS PURCHASE (Bloomberg, Jun. 2012).
\textsuperscript{16} Making Its Mark as Top IPO Destination, THE BORNEO POST (Jul. 2012).
\textsuperscript{17} THE STAR, S-E ASIAN FIRMS FLEX DEAL-MAKING MUSCLES (Aug. 2012).
\textsuperscript{18} THAI BILLIONAIRE ALREADY WINNING IN TUSCLE WITH HEINEKEN; RETAIL (Bloomberg, Aug. 2012).
the lead in managing these transactions through their superior branding, extensive experience and client rapport especially with the investment banks and other advisors who typically drive these deals. Lawyers from domestic law firms who are brought in to these deals tend to play a secondary or supporting role. Nevertheless, there is no reason why lawyers in domestic firms cannot play a more active role in managing these deals especially, if none or not much of the transactions is governed by US or English law.

**CONCLUSION**

Liberalization of the ASEAN legal market is not a zero sum game. We should have a change of mindset and embrace liberalization by investing in international networking and strategic alliances with foreign firms. The entry of foreign firms into the local industry needs not be to the detriment of local lawyers. We should not lose sight of the opportunities and benefits which could be available from the new liberalized market. Nor, however, should we dive in; head first, without a strategy or plan of action. We should draw lessons from the experience of lawyers in China who have managed to do well in a more liberalized and competitive environment with the entry of international law firms. The challenge for local lawyers is to look for opportunities or “white spaces” created by the entry of foreign law firms into the local legal market. Not all areas of practices will be of interest to the foreign firms. The cost structure and skills of international firms are geared towards more high-end transactions where they can command premium fees. In “run of the mill” transactions where they cannot compete on cost, it is likely they will collaborate with domestic law firm. This will inevitably create more opportunities for new practices, clients and products which local lawyers can and should benefit thru collaborations with the international firms.