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## INTERNATIONAL LAW FIRMS IN CHINA: MARKET ACCESS AND ETHICAL RISKS

*Mark A. Cohen\**

Unlike their Chinese counterparts seeking to expand overseas, international law firms in China face enormous difficulties establishing and expanding their presence in the Chinese legal market. In the United States, Japan, and the European Union, Chinese law firms are generally able to establish offices, hire local lawyers, and engage in comprehensive corporate law and litigation services. Their ability to engage in these services is consistent with global trends to provide comprehensive legal services to clients who desire legal advice for their key global markets. Similar opportunities are denied or restricted from foreign law firms within China.

The situation of foreign law firms, ten years after World Trade Organization (WTO) accession, has very much become one where the “cobbler’s son wears no shoes.” Market access liberalization offered to foreign law firms at WTO accession was comparatively small, and was largely limited to permitting foreign law firms to open up more than one representative office. However, such offices continued to be restricted in the type of services they could provide.<sup>1</sup> By contrast, accounting, bookkeeping, and taxation services were considerably more liberalized, including permitting the licensing of foreign accountants by Chinese authorities.<sup>2</sup> As a result, many WTO members continue to encourage China to liberalize its legal services market, although little progress has been made since the implementation of China’s accession commitments.<sup>3</sup>

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1. Geographic and quantitative limitations were to be eliminated within one year after China’s accession to the WTO. Business scope was limited to providing consultancy on foreign legislation and on international conventions and practices; to handle legal affairs of the country/region where the lawyers of the law firm are permitted to engage in lawyer’s professional work; to hire local counsel and enter into long-term relations with Chinese law firms; and “to provide information on the impact of the Chinese legal environment.” Ministerial Conference, Doha, UAE, November 9–13, 2001, *Report of the Working Party on the Accession of China*, at 6, WT/MIN(01)/3/Add.2, Addendum, Schedule CLII, Part II (Nov. 10, 2001).

2. *Id.* at 7.

3. See, e.g., Trade Policy Review Body, *Record of the Meeting*, ¶ 478, WT/TPR/M/230 (June 29, 2010) (“Members encouraged China to further liberalize its services, especially banking, insurance, electronic payment systems, telecommunications, express delivery, and legal services.”); General Council, *Minutes of the Meeting*, ¶ 8, WT/GC/M/124 (Apr. 14, 2010) (“In the area of services, Chinese regulatory authorities continued to frustrate efforts of US providers of banking, insurance, express delivery, telecommunications and legal services to achieve their full market potential in China, through the use of obstacles such as

Currently, foreign law firms are subject to a number of barriers in China.<sup>4</sup> The American Chamber of Commerce, Legal Committee, of which I was a former co-chair, has identified several issues.<sup>5</sup>

First, international law firms are unable to hire or be owned by qualified People's Republic of China (PRC) lawyers with active PRC law licenses in China.<sup>6</sup> Under current legal regulations, a licensed PRC lawyer must first suspend his or her license and may not practice PRC law while at an international law firm in China. Foreign lawyers cannot sit for the bar exam or practice Chinese law.<sup>7</sup> The suspension of their license limits employment opportunities for PRC lawyers, as well as the ability of international law firms to provide global services. It also deprives foreign law firms of much needed first-hand knowledge of Chinese legal process.

Second, foreign lawyers are restricted in their appearances before PRC government agencies.<sup>8</sup> Although China was required to permit foreign lawyers "to provide information on the impact of the Chinese legal environment" as part of WTO accession,<sup>9</sup> foreign lawyers are frequently barred from participating in certain types of meetings with Chinese government agencies, even when in the company of local counsel. These restrictions appear to vary by agency, and indeed, may even vary by individual within that agency.

Third, foreign law firms experience burdensome Representative Office registration requirements.<sup>10</sup> Foreign law firms must justify the need to establish their representative office by the "social and economic development conditions of the proposed location" and other vague considerations.<sup>11</sup> A foreign law firm must also wait three years after

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an opaque regulatory process, overly burdensome licensing and operating requirements, and other means.").

4. These are barriers that primarily apply to commercial work, whether of a consultancy or litigation nature. Chinese lawyers have been subject to considerable political pressures for the type of work that they perform; such pressures and limitations are beyond the scope of this Essay. Foreign law firms do little, if any, work involving advice on Chinese criminal law.

5. See AMERICAN CHAMBER OF COMMERCE: PEOPLE'S REPUBLIC OF CHINA, AMERICAN BUSINESS IN CHINA: 2011 WHITE PAPER, 296-300 (2011).

6. *Id.* at 296-98.

7. See Trade Policy Review Body, *Minutes of Meeting: Addendum*, at 280, WT/TPR/M/199/Add.1 (Aug. 28, 2008) ("Like many other WTO Members, China does not allow foreign law firms to practice domestic law. Therefore, foreign law firms cannot employ Chinese registered lawyers. Nevertheless, this restriction does not affect[] business of the foreign law firms in China within the scope as defined in China's accession commitment, because China allows foreign law firms to establish long-term entrustment relations with Chinese law firms to provide related legal services. China has not made commitments on non-Chinese nationals practicing Chinese law in its accession negotiations. China implements a uniform State Judicial Examination system. The participants of the examination not only include lawyers, but also first-time judges and procurators. Therefore, according to the Lawyer's Law and related regulations, only Chinese nationals are eligible to take the State Judicial Examination.").

8. AMERICAN CHAMBER OF COMMERCE, *supra* note 5, at 298.

9. *Report of the Working Party on the Accession of China*, *supra* note 1, at 6.

10. AMERICAN CHAMBER OF COMMERCE, *supra* note 5, at 298.

11. *Id.*

opening its first representative office before it can open another.<sup>12</sup> These restrictions delay market access, and can impede use of market considerations to determine where to open an office.

Finally, foreign law firms face discriminatory tax treatment.<sup>13</sup> Foreign law firms potentially face double taxation on profits while a domestic firm only experiences one level of taxation at a lower rate. This is because foreign law firms cannot organize as partnerships under PRC law; as a result, foreign law firms are taxed once on profits and a second time on repatriations of after-tax profits. The income tax rate received by a PRC local lawyer is typically 14.25 percent, including PRC business tax, which can be further reduced to 3 percent on certain types of revenue.<sup>14</sup> The income of a foreign lawyer is subject to 5.5 percent PRC business tax plus 25 percent income tax payable by the representative office, and personal income tax subject to progressive rates that quickly rise to 45 percent.<sup>15</sup>

The American Chamber of Commerce in Beijing, along with other associations, believes that these policies are not in the interest of either clients or Chinese lawyers, and are inconsistent with the trend in East Asia and around the world of opening legal services markets more widely to international law firms.<sup>16</sup>

As a separate issue, there may also be restrictions on the practice of patent and trademark lawyers, which may be governed by separate standards. China, like the United States, has a patent bar that is licensed by its patent office. It also has a trademark bar that is separately licensed by the trademark office. The Agreement on Trade Related Aspects of Intellectual Property Rights (TRIPS), which governs the intellectual property obligations of WTO member countries, permits certain exceptions to national treatment in intellectual property regarding appointment of patent and trademark agents in

judicial and administrative procedures, including the designation of an address for service or the appointment of an agent . . . only where such exceptions are . . . not inconsistent with the provisions of this Agreement and where such practices are not applied in a manner which would constitute a disguised restriction on trade.<sup>17</sup>

Previous to WTO accession, China engaged in additional restrictive practices of only permitting specially designated trademark or patent agents to represent foreigners. While these provisions were removed, the obligation to hire a locally appointed agent remains, thereby further

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12. *Id.*

13. *Id.*

14. *Id.*

15. *Id.*

16. *Id.*

17. Agreement on Trade Related Aspects of Intellectual Property Rights art. 3.2, Apr. 15, 1994, Marrakesh Agreement Establishing the World Trade Organization, Annex 1C, 1869 U.N.T.S. 299 (1994).

restricting foreign law firms from direct practice in this area.<sup>18</sup> Moreover, restrictive trademark practices, when compared to patent office practices and international trademark applications via the Madrid Protocol, suggest that the practices may not be operating at the minimum permitted by Article 3.2.<sup>19</sup>

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18. During a review of China's legislation by the Council for Trade-Related Aspects of Intellectual Property Rights, the Chinese delegation answered questions from other nations about its intellectual property legislation:

[China:] The requirement for foreigners to use a designated trademark agency is an international practice rather than something unique in China. Such practice is in full compliance with the requirement of the [sic] paragraph 3 of Article 2 of the Paris Convention and Article 3 of the TRIPS Agreement. The problem that "only some trademark agents can be used by foreign enterprise" no longer exists. From 1 January 2001, all trademark agencies legally established are entitled to deal with foreign business on trademarks. Moreover, foreigners who need to use an agent refer to those who are not domiciled or do not have industrial or commercial establishment in China. . . .

[Question from Japan:] Under Article 19 of the Chinese Patent Law, foreign applicants are required to carry out procedures to obtain a patent right in the People's Republic of China through a patent attorney designated by the Chinese government. Please explain how this condition can be considered as being consistent with Article 3.1 of the TRIPS Agreement on National Treatment.

[China:] While Article 3.1 of the TRIPS Agreement provides for the principle of National Treatment, the said Article also provides that the principle of National Treatment is subject to the exceptions as already provided for in the Paris Convention, the Berne Convention, the Convention of Rome or the Treaty on Intellectual Property in Respect of Integrated Circuits. Article 2(3) of the Paris Convention reads: "The provisions of the laws of each of the countries of the Union relating to judicial and administrative procedure and to jurisdiction, and to the designation of an address for service or the appointment of an agent, which may be required by the laws on industrial property are expressly reserved." Secondly, it is international practice to require a foreign applicant, who has neither domicile nor real and effective industrial or commercial establishments in the territory of a country in which the patent application is filed, to appoint a representative to proceed before the patent office of the countries concerned. For instance, Article 8.1 of the Japanese Patent law provides that a resident abroad shall appoint a "patent administrator" who has his domicile or residence in Japan to proceed before the Japanese Office with respect to his patent. Therefore, it is our understanding that Article 19 of the Chinese Patent Law relating to the appointment of an agent is in full consistency with the provisions in the TRIPS Agreement.

Council for Trade-Related Aspects of Intellectual Property Rights, *Review of Legislation: China*, at 5, 29–30, IP/Q/CHN/1 (Dec. 10, 2002).

19. The US delegation noted the following reasons:

- (a) The restrictions only apply to foreigners applying for trademarks in China, irrespective of whether they have a place of business in China.
- (b) Only some trademark agents can be used by foreign enterprises.
- (c) This rule only applies to trademarks. No similar rule applies to patents. China's patent law has a less restrictive provision: "where any foreigner, foreign enterprise or other foreign organization having no habitual residence or business office in China applies for a patent, or has other patent matters to attend to, in China, he or it shall appoint a patent agency designated by the patent administrative organ under the State Council to act as his or its agent."

For the many law firms operating or contemplating opening an office in China, there are also ethical restrictions on practicing Chinese law that may go even deeper than those just outlined. Two key issues involve the implications of a Chinese office for a multijurisdictional practice, including prohibitions on providing advice on Chinese law, and the attorney-client privilege. If the Chinese prohibition on rendering advice extends to the U.S. headquarters of a Chinese representative office, this could have a significant dampening effect on the willingness of foreign firms to advise on Chinese transactions, or even appear as expert witnesses in litigation involving a Chinese law in the United States. Such an effect could disserve the interests of Chinese companies that are increasingly facing litigation in China, that may be asserting forum non conveniens or other claims based on Chinese practice, and who require knowledgeable U.S. counsel that can also provide opinions on the meaning of relevant Chinese law. As I noted in a letter to the *Washington Lawyer* in 2002:

In countries such as China, where foreign law firms cannot advise on Chinese law and Chinese lawyers are required to suspend their license when they practice with the foreign law firms, there are both ethical and malpractice risks. How can a foreign law firm advise on Chinese law when it is legally required not to do so? How can a client ensure that his communications are kept confidential? Must one advise a client that a firm is legally required not to provide the advice that is being requested? Whatever the answers are, they are not easy.<sup>20</sup>

The law on attorney-client privilege may be even more problematic. As a recent publication more gently put it: “[T]he law is silent on whether communications between attorneys and their clients shall be kept confidential under any sort of attorney-client privilege, and there is no custom of such a privilege vis-à-vis government investigations.”<sup>21</sup>

Does such a privilege exist in the case of foreign-law offices resident in China? The answer is likely not. A leading Chinese law firm, King and Wood, summarized the situation as follows:

Under Chinese law, all parties with the knowledge necessary to decide a case are obligated to provide that information in court, and confidential communication between attorneys and clients is not exempt from this disclosure in court. International conflict of law principles establish that a court with jurisdiction over a case will establish the procedural rules for the case. Therefore, in China, foreign lawyers must comply with the Civil

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(d) Foreigners making applications pursuant to the Madrid Protocol do not require use of Chinese agent. Implementing Rules for Madrid International Registrations (Sec. 2).

(e) Points (c) and (d) indicate that *use of a trademark agent is not necessary to secure enforcement of China's trademark laws and is a [sic] unjustified restriction on trade.*

Council for Trade-Related Aspects of Intellectual Property Rights, *Review of Legislation: Questions by the United States*, at 3, IP/C/W/365 (Aug. 29, 2002) (emphasis added).

20. Mark Cohen, *Multijurisdictional Practice*, WASH. LAW., May 2002, at 5.

21. H. STEPHEN HARRIS ET AL., *ANTI-MONOPOLY LAW AND PRACTICE IN CHINA* 296 (2011).

Procedure Law and the Lawyer's Law, and they must testify in PRC courts about the evidence they have knowledge of.

Article 3 of the *Administrative Rules for the Representative Offices of Foreign Law Firms* establishes that foreign law firms and their attorneys must follow the PRC's laws, rules, and regulations. Furthermore, Article 3 requires foreign attorneys in foreign law firms to strictly comply with the PRC's rules for lawyers' professional ethics and practice. Furthermore, foreign law firms and their attorneys must not jeopardize China's national security and public interest when they provide their legal services in China. *This provision indicates that, under PRC law, the rights and obligations of foreign attorneys working in China are the same as the rights and obligations of Chinese lawyers.*<sup>22</sup>

Although I am unaware of any instance where a foreign lawyer has been forced to disclose client matters to a Chinese authority, clients who engage U.S.-based counsel are less likely to risk a loss of attorney-client privilege for China-related matters. Consistent with relevant ethical rules, I also believe that foreign law firms may wish to consider warning their clients that their engagement of their representative office risks at least the loss of the attorney-client privilege with respect to proceedings that may be occurring or likely to occur in China.<sup>23</sup> Such an obligation to warn clients, or obtain informed consent, would appear to be implicit in the obligation to maintain attorney-client confidences that is found in all ethical codes in the United States. Furthermore, although an office in China is critical for many types of legal work, there may actually be strategic advantages to not opening an office, or segregating work where there is a risk of losing the privilege.

#### GENERAL SUGGESTIONS

The process of integration of foreign law firms into China carries many benefits both for the foreign firms as well as for the Chinese firms and industry. Most important, in order for China to continue attracting foreign investors, it should continue the process of allowing further integration of its legal system. This includes engagement on regulatory, tax, and ethical issues. Moreover, as China increasingly becomes a key venue for global litigation, competition filings, IP filings, and other matters, it is likely to become more important to Chinese and foreign companies that they may be served by one global firm which can insure a consistency of approach and a deep knowledge of their client's business practices. This does not, of course, preclude some use of local counsel, but it does mandate that

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22. Gui Hongxia & Li Xiang, *Attorney-Client Privilege: Is This Privilege Extended to Foreign Lawyers in China?*, KING & WOOD (Mar. 2009) <http://www.kingandwood.com/article.aspx?id=attorney-client-privilege-03-china-bulletin-2009&language=en> (second emphasis added).

23. See D.C. RULES OF PROFESSIONAL CONDUCT R. 1.6(a) (2007) ("[A] lawyer shall not knowingly: (1) reveal a confidence or secret of the lawyer's client."); *id.* at R. 1.6(e) ("A lawyer may use or reveal client confidences or secrets: (1) with the informed consent of the client; (2)(A) when permitted by these Rules or required by law or court order.").

international counsel has more than a passing familiarity with local legal practice.

The easiest task to accomplish in reforming the current system is likely of a regulatory nature. First, all licensed Chinese attorneys hired by foreign law firms might be allowed to practice within China's legal system. As a part of this initiative, foreign lawyers or their associates should be given equal access to meetings with government agencies. Second, and in conjunction, Chinese law firms should likewise be able to develop multi-jurisdictional practices, through the employment of foreign-qualified lawyers, and the ability to enter into partnerships with, foreign-qualified lawyers.

State bars in the United States, as licensing entities for lawyers, also have an important role to play in encouraging a level playing field. Interestingly, the sole federal agency with the authority to license lawyers, the United States Patent and Trademark Office (USPTO) has not generally played an active role in promoting legal services market access. This may be because of the international nature of many patent filings, and the general willingness of China's patent office to permit foreign counsel to accompany local counsel in relevant proceedings, notwithstanding restrictions that apply to directly opening an office in China.

With regard to ethical issues, relevant state bars may wish to establish clear choice of law rules<sup>24</sup> so that U.S. lawyers who may be compelled to reveal information by a foreign jurisdiction do not suffer ethical consequences in the state(s) of their admission—or worse, be placed in a situation where one jurisdiction compels disclosure while another jurisdiction prohibits it. Not to do so, while at the same time achieving enhanced market access, would be—to continue my earlier metaphor—placing the cobbler's son at long last into shoes, but ones that could be potentially dangerous to use.

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24. For example, District of Columbia Ethical Rule 8.5 has a choice of law provision:

(1) For conduct in connection with a matter pending before a tribunal, the rules to be applied shall be the rules of the jurisdiction in which the tribunal sits, unless the rules of the tribunal provide otherwise, and

(2) For any other conduct,

(i) If the lawyer is licensed to practice only in this jurisdiction, the rules to be applied shall be the rules of this jurisdiction, and

(ii) If the lawyer is licensed to practice in this and another jurisdiction, the rules to be applied shall be the rules of the admitting jurisdiction in which the lawyer principally practices; provided, however, that if particular conduct clearly has its predominant effect in another jurisdiction in which the lawyer is licensed to practice, the rules of that jurisdiction shall be applied to that conduct.

*Id.* at R. 8.5(b).