The Global Law Firm's Survival Guide to Russia

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It is difficult to believe that, in the not-so-distant past, Russia was one of the hottest legal markets on the planet.

Throughout the mid-2000s, record oil prices drove Russia's energy-dependent economy to dizzying heights. Keen to tap into this veritable economic gusher, cross-border investors poured bucket loads of cash into the market, and law firms scrambled to keep pace with the glut of big-ticket transactional work. Among the elite dealmakers that profited were international firms such as Cleary Gottlieb Steen & Hamilton; Hogan Lovells; Skadden, Arps, Slate, Meagher & Flom and the U.K. Magic Circle as well as some with broader practices such as Baker McKenzie and Dentons.

Many of these firms had been in Russia since its legal market began with the fall of the Soviet Union. With the leading Russian firms, such as Alrud and Egorov Puginsky Afanasiev & Partners (EPAM), lacking the head start that domestic firms enjoy in most markets, the global firms had the edge, dominating their chosen practice areas. The intense competition for associates and Grade A office space saw rental costs and lawyer salaries skyrocket, even hitting New York levels at some firms.

Those heady days are now long gone. A double whammy of the global financial crisis and, perhaps even more importantly, a severe slump in the value of oil, plunged the country into a crippling recession. Worse yet, after Russia used military action to annex Crimea from Ukraine in 2014, the United States and European Union (EU) responded swiftly with extreme economic sanctions.

With foreign investors steering clear and Russian companies no longer able to access western capital, cross-border transactional activity has been significantly stifled. Leading British and American firms have had to adapt to survive. For many, this has meant downsizing and restructuring practices. K&L Gates pulled out entirely, closing its small Moscow office in late 2015. But for all, it has meant feeding on a leaner diet of domestic work for Russian clients, increasingly under Russian law, and fending off growing competition from local law firms that are arguably better suited to the new environment.

"Things are very different now," says Herbert Smith Freehills' Russian managing partner Alexei Roudiak, with a resigned sigh. Put simply, the Russian legal market has become more Russian.

"You just don't see a lot of big international deals in Russia anymore," says Dmitry Nikiforov, chair of the Moscow office of Debevoise & Plimpton. Nikiforov says that his firm has benefited from its decision following the 1998 crisis to start targeting Russian clients, including Aeroflot and Norilsk Nickel, having previously focused on handling inbound work referred by other offices.

"At that time [in 1998], lots of western money left Russia, which was a real hit for a lot of the [global] law firms here," he says. "We realized we needed to have a strong Russian clientele in order to survive in this market, which has really helped us now. For Russian companies that aren't affected by the sanctions, it's largely business as usual."

Arguably, the sanctions against Russia leave American firms at a disadvantage compared to their European rivals. The U.S. blacklist is more extensive than those of the EU, while its sectoral sanctions are stricter, with European sanctions allowing for various exemptions, such as in relation to trade finance.

Russian oil company PJSC Lukoil, a longstanding client of Akin Gump Strauss Hauer & Feld's Moscow office, was hit by U.S. sanctions, but not affected by EU sanctions, for example. Some lawyers say it is a gray area whether a European firm having an office in the United States or even employing U.S.-qualified lawyers would mean it could be bound by the U.S. sanctions.

Yet most lawyers in Russia seem relatively unconcerned by sanctions. In fact, when it comes to client activity, many feel the real damage has been caused by the specter of the sanctions, and not the sanctions themselves. "The sanctions actually haven't had too severe an impact—the main issue is perception," says Dentons' Moscow managing partner Florian Schneider. "The word 'sanction' itself leads people to think that business with Russia is generally prohibited, which isn't necessarily true."

Each of the 17 partners interviewed for this feature agree it is the continued depression in global oil prices, and not sanctions, that has been the most significant blow to the market. "If oil were back at $100 per barrel, there'd be a lot more lawyers at international firms in this town," says Scott Senecal, a corporate partner in Cleary's Moscow office.

For global law firms, the impact of the most severe sanctions imposed against Russia—the dreaded blacklists—was straightforward and immediate. American and European companies—including law firms—are prohibited from doing business with so-called "specially designated nationals" (SDNs), so any client on the list had to be dropped entirely. (This disparate group of clients were generally then picked up by domestic rivals or, in some instances, transferred to independent firms in Hong Kong that had the required English-law capability to handle Russian transactions.)

But while most of the 12 international law firms interviewed for this feature admitted to having had some blacklisted clients that are now former clients, the direct effect on Big Law was relatively slight.

"U.S. law firms cannot do anything that could be seen as beneficial to a [blacklisted entity],' says Baker Botts' Moscow managing partner Maxim Levinson, who said his firm had to "abstain from some projects" due to blacklisted clients. "It wasn't a huge volume of work, but we would love to still have it." (Levinson declined to provide any specific client names.)

Instead, international firms have more commonly encountered SDNs as counterparties to nonsanctioned clients. Take Russian broadcaster CTC Media, a client of Morgan, Lewis & Bockius, for example. The Nasdaq-listed company was not placed on any sanctions list, but was exposed indirectly because 25 percent of its business was owned by Telcrest Investments Ltd. Telcrest is in turn controlled by Bank Rossiya, described by the U.S. Department of the Treasury as "the personal bank for officials of the Russian Federation" and is blacklisted. (Morgan Lewis, which in 2011 teamed up with Russian law firm EPAM to advise Telcrest on its $1 billion investment in CTC, declined to comment.) CTC, which was 38 percent-owned by Sweden's MTG, then had to react to new Russian legislation—announced shortly after the western sanctions and formally introduced in 2016—that limits foreign ownership in media companies to 20 percent. Morgan Lewis was again involved when the company eventually sold a 75 percent stake to UTH Russia, which was advised by Cleary. (Hogan Lovells' Moscow managing partner Oxana Balayan says the media law proved "an incredibly good source of M&A work and very good money for law firms," but that wave has now subsided, she notes.)

International law firms are still able to act for clients affected by sectoral sanctions, however. These restrictions, which block access to western capital and technology across various sectors, have had a particularly detrimental effect on international finance and energy practices, and have severely impacted the ongoing and new project activity of major Russian clients. This includes the two main players on the market, PJSC Gazprom and Rosneft Oil Co PJSC, which have historically worked with firms such as Allen & Overy, Baker Botts, Freshfields Bruckhaus Deringer, Linklaters, and White & Case. (Law firms also have to be careful in relation to a ban on western companies providing finance to sanctioned entities. If a firm advises a sanctioned client and its invoice isn't paid within a month, it could be perceived as having provided a loan, and, thus, viewed as in breach.)

Firms have seen a number of major projects delayed. Baker Botts recently represented Russia's Rosneft on its $4.1 billion cooperation deal with NYSE-listed North Atlantic Drilling, a subsidiary of offshore rig company Seadrill, which were both represented by Slaughter and May and Russian firm Alrud. The closing date has been repeatedly extended—most recently to May 2019—due to the ongoing sanctions. At the time of writing in early July, Norway's Seadrill is in negotiation with lenders over a debt restructuring.

"Some of our projects were put on hold," says Botts' Levinson, "but there's nothing we can do other than sit and wait." As in the United States, Baker Botts is best known in Russia for its energy practice. But Levinson says the sector only accounts for a third of the firm's revenue, alongside corporate, technology and litigation. The firm has reacted to the slowdown in M&A work by moving some lawyers from its Russian corporate department to its aviation finance practice, which acts for the country's largest airline, PJSC Aeroflot, and is "booming," he says.

Hogan Lovells' Balayan says the firm has had to alter the type of work it handles for clients such as Rosneft and Sberbank, a state-owned banking and financial services company that is also on the sanctions list. When Sberbank sold its Ukraine subsidiary earlier this year, to a consortium led by Latvia's Norvik Banka, Hogan Lovells was "simply not able to take this instruction—we couldn't even pitch," Balayan adds. Instead the work went to Herbert Smith Freehills.

For high-end deal lawyers in Russia, the past five years have been bleak. There have been significant declines in cross-border activity across finance, capital markets, private equity and M&A. This lucrative transactional work historically formed a core part of the Russia practices of the elite U.S. and U.K. firms, such as Cleary; Skadden; and the magic circle.

The aggregate value of Russian M&A deals fell from over $110 billion in 2012 to just $30 billion in 2015, according to Mergermarket data. The reversal in fortunes for capital markets practices has been even more pronounced. In 2007, Linklaters acted on $18 billion of Russian IPOs within the space of a single week. In each of the past three years, the aggregate value of all Russian IPOs has been less than $1 billion. Russian Eurobond issues—a key practice of Allen & Overy—meanwhile, fell from over $50 billion in 2013 to just $3.8 billion in 2015.

"The last few years have been very difficult," says Alexey Kiyashko, a corporate partner in Skadden's Moscow office. "The Russian economy had proved more resilient to the recession than anyone expected, but then Ukraine happened. The sanctions significantly impacted foreign investors' appetite for Russia and the ability of Russian companies to raise capital."

Skadden is among the many international firms that downsized its Moscow office—dropping from 21 attorneys to just eight, according to NLJ 500 data—although Kiyashko says it remains committed to the market. "There is absolutely no talk of closing the office," he says, although the firm is in the process of returning some space to its landlord. Skadden hasn't made any layoffs in Russia. Instead, like other firms, it has contracted through natural attrition and by placing lawyers with its clients in Russia—something Kiyashko describes as a "win-win: it's brought our costs down and at the same time improved our relationships with our clients." Skadden recently extended its lease in Moscow, having renegotiated its rent by what Kiyashko says is a "significant percentage," and is one of the few international firms still offering New York-level salaries to Russian associates. Others, including Cleary, stopped paying New York rates to Russian attorneys several years ago.

Many finance lawyers have spent recent years focusing on restructuring and distressed deals, although there are tentative signs that both the debt and equity markets may be reopening.

Cleary advised the Russian state on a series of large sovereign Eurobond offerings in late 2016 and early 2017. The deals were followed by a number of successful issues by private borrowers, with negative yields in Europe helping ensure there is still high demand for non-sanctioned Russian credit.

Then, in February, White & Case advised Russia's largest toy retailer, PAO Detsky Mir, on its $360 million IPO. The deal, which had been delayed several times, was the first big Russian IPO since the sanctions and was heavily oversubscribed. The shares priced at the bottom of the expected range, however, suggesting that investors remain cautious. W&C also acted for Detsky's selling shareholder, PJSFC Sistema, which has said that it may list its agriculture business, Steppe, later this year. Sistema is a key client of Latham & Watkins, which acted on its $1.56 billion IPO back in 2005. Former Moscow managing partner Anya Goldin spent over six years at the company as its general counsel. Any future IPOs are unlikely to involve U.S. or U.K. listings, however, which lawyers say are off the table "for political reasons."

With Russian clients no longer able to access western markets, many have turned to Asia in order to secure financing and technology. There has already been considerable activity with China and Japan, while lawyers in Russia are also seeing increasing workflows from India, Singapore and South Korea.

Cleary advised Russian's largest petrochemicals group, PJSC SIBUR Holding, on its sale of two 10 percent stakes: to China Petroleum & Chemical Corp., for $1.3 billion; and to China's state-owned Silk Road Fund, for an undisclosed fee. Herbert Smith Freehills and Baker Botts, meanwhile, scored the lead roles on the $1.2 billion acquisition of a 9.9 percent stake in the Yamal LNG project, which had been struggling to raise funds due to sanctions, by China's Silk Road Fund.

Law firms, such as Alrud and Dentons have been establishing Asia practices in Russia to target this burgeoning flow of work. In 2016, Goltsblat BLP hired K&L Gates finance partner and Japan expert Sergey Milanov to lead a new Asia desk in Moscow. And it relocated Russian M&A partner Ian Ivory to Goltsblat's Hong Kong office. Goltsblat says the firm earned more than $2 million in fees from Asian clients last year—nearly 7 percent of its total revenue—and has been hired for the first time by China Development Bank, state-owned investment company CITIC Group Corporation Ltd. and Japanese hotel chain Tokyo Inn.

While the sanctions have made life more challenging for international firms in Russia, they have also provided lucrative sources of compliance and regulatory work. Most global firms have launched specialist sanctions practices, staffed by lawyers in various practices including litigation, investigations and commercial law. "It doesn't really compensate the work we've lost because of less foreign investment, but it's still nice to have," Dentons' Schneider says.

Compliance has become an increasingly important area for firms in Russia, due to the higher levels of scrutiny by corporate boards on what is now seen as a more perilous market, and of Russian and international authorities. (Deutsche Bank was recently fined about $630 million by the New York Department of Financial Services and the U.K.'s Financial Conduct Authority for failing to prevent $10 billion of money laundering in its Russian subsidiary.)

And while Russia's increased risk profile has seen many U.S. and European investors look elsewhere, those already heavily invested have remained in the market. "Lots of our clients have very large operations in Russia," says Baker McKenzie's CIS managing partner Sergei Voitishkin. "It wasn't a question for them to withdraw; the question was how to adapt and remain competitive."

Firms have kept busy advising these clients on non-transactional areas, such as employment, intellectual property, technology and tax, which has also been driven by the continued reform of Russia's tax legislation.

There has even been a trend for Russian law to be used on transactions instead of English law, which has long been the governing law of choice in Russia. This has partly been driven by the continued amendment of Russia's civil code, most notably in 2014, when amendments were made to introduce classic English-law M&A provisions, such as reps and warranties, put and call options, and shareholder agreements. English law is still de rigueur for investments carried out via offshore holding structures and for most big-ticket deals, where they exist. However, lawyers say many Russian companies—particularly those that are state-controlled—prefer Russian law to be used.

"Russian law is now a pretty close approximation to English law," says Cleary's Senecal. "The problem is, [using Russian law] would normally tie the disputes to being resolved in Russia. That's something that many clients would rather avoid." (In February, new rules were introduced that require any dispute relating to a Russian company be heard either in Russian courts or in a government-recognized arbitral institution. In theory, international arbitral institutions could apply for such a license, but none have to date.)

While many western companies remain reluctant to engage in Russian litigation, the practice is booming. International firms have historically tended to steer clear of Russian litigation, which has instead been dominated by domestic law firms and specialist criminal advocates, but several have now moved to develop their disputes offerings.

Last September, Baker Botts hired two disputes partners from Quinn Emanuel Urquhart & Sullivan, including Moscow office head Ivan Marisin. Quinn Emanuel quickly responded by hiring former Interros general counsel Kirill Parinov, who was already working with the firm on a part-time basis. In June, Dentons hired Konstantin Tretyakov from Russian firm EPAM to lead a new white-collar and government investigations practice.

"The rule of law is strengthening and courts are improving, so clients are more willing to litigate [in Russia] as they're more confident they'll get an objective decision," says Dentons' Schneider. "Ten years ago, investors would never litigate against the state, but now it's really common to challenge the decisions of tax and other authorities in court."

If international law firms have struggled in recent years, leading Russian firms such as Alrud, Goltsblat BLP and EPAM have thrived. Goltsblat BLP has grown its head count by 60 percent since its formative merger in 2009, to 112 lawyers, and won work from 260 new clients last year. And Alrud's revenue has increased by around 20 percent since 2014. (The firm declined to comment on the size of its gross revenue.)

To a certain extent, the various market changes have all played to their strengths: Russian firms have close relationships with Russian clients, are well-versed in Russian law and, crucially, are not bound by western sanctions. With portions of the market out-of-access to global firms, domestic players have sought to fill the gap.

"The last three years have been excellent for us," says Vassily Rudomino, the co-founding partner of 100-lawyer Alrud. "International firms are in survival mode [in Moscow] and clients want to use Russian firms—because of variety of specialization, local knowledge and fees, but also for geopolitical reasons—which has allowed us to grow more easily."

Rudomino says he sees a limited "window of opportunity," which he puts at around another year, for Russian firms to gain a foothold on their international rivals. "Once the geopolitical situation improves, international investment will return and international firms will return to growth," he says. "We're focused on exploiting the opportunity to the maximum." To that effect, the firm has a new strategy that for the first time includes separate business plans for each practice group.

Rudomino says the broader practices of most Russian law firms has also been a competitive advantage in a market with a paucity of high-end transactional work. But the growth of many Russian law firms is being hampered by their own reluctance to transition away from a founding-partner model and open up their equity to new partners. In fact, no Russian firm promoted a partner internally until 2007, when Alrud promoted two associates. (Alrud now has eight partners and is due to promote a ninth, all of which have full equity status—still a much higher leverage than you'd see at most global firms.)

Other Russian firms have also expanded their partnerships in recent years. EPAM started with three founders and now has over 30 partners, for example, while Goltsblat has promoted five new partners internally since the start of 2016, including two equity partners.

"Many Russian law firms are struggling to grow as they have structural problems with the founding partner model," Rudomino says. "I see more people leave Russian law firms and set up their own practices than I do stable, organic growth."

Indeed, a combination of a lack of career opportunities at Russian firms, downsizing at international law firms and the underlying market conditions has led to the formation of a number of boutique law firms in recent years. In 2015, Freshfields Bruckhaus Deringer's Moscow disputes head, Maxim Kulkov, left the firm with four other lawyers to launch a litigation boutique, while White & Case litigator Grigory Chernyshov has also set up his own standalone disputes practice. Lawyers from Russian firms Liniya Prava and Vegas Lex have made similar moves. In addition to not being restricted by conflicts or sanctions, independent practices are also able to be more flexible with pricing—Kulkov's KK&P Trial Lawyers has said its rates are up to 40 percent lower than they charged at Freshfields.

International law firms have themselves become progressively Russian, however. Almost all of their lawyers are Russian qualified, while most are now managed by Russians—a notable change from the pre-crisis years, when ex-pat office heads were common. The majority of ex-pat partners have since retired or relocated to other offices. "The days when western firms felt it necessary to have westerners manage their Moscow offices are long gone," says Sebastian Rice, Akin Gump's London chair. Four years ago, Rice was replaced as Akin Gump's Moscow office head by Natalia Baratiants, a member of the firm's management committee.

Looking to the future, the overriding consensus among Russian lawyers is that the sanctions—and the broader market conditions—are here to stay. In a straw poll of partners at 12 law firms in Russia, the soonest anyone thought the sanctions would be lifted is in two years' time. The longest was 10 years. "There was some optimism when Trump was elected that he might lift the sanctions, but we realize it's not going to happen," says Skadden's Kiyashko. "There is even talk of more sanctions, which would make everyone's life more difficult."

International firms insist they are here to stay, too: All of the partners interviewed for this story say their firms are in it for the long haul. (Whether firm management privately shares the same commitment is another matter entirely.) And there's now at least a degree of stability in the market. Lawyers and clients have lived with sanctions for nearly three years, growing more comfortable with the regime.

And there are some signs of improvement, if you look hard enough. Foreign direct investment in Russia hit $7 billion in the first quarter of 2017, according to government data. That's less than a tenth of the level seen during the height of the boom in 2008, but is already more than all of last year. Ernst & Young data, meanwhile, shows the number of transactions in Russia involving foreign capital increased 61 percent in 2016.

Experienced Russia hands have been through all this before. "Law firms in Russia have always had to take a longer-term view," says Alexander Chmelev, a tax partner in Baker McKenzie's Moscow office. "We've been here since 1989, so we've gone through the collapse of the Soviet Union, the armed confrontation and dismissal of the Russian legislature in October 1993, the Chechen wars, the 1998 [sovereign] default, the bombing of Yugoslavia [by NATO, which destroyed Russia's relations with the West], the Georgian war, the global financial crisis and the Ukraine sanctions. The past has taught us that you shouldn't overreact to political events—business will always adapt in the end."

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