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## CHINA'S NEW FOREIGN LAW FIRM REGULATIONS: A STEP IN THE WRONG DIRECTION

Jane J. Heller<sup>†</sup>

*Abstract:* Following China's accession to the World Trade Organization ("WTO"), the Chinese government issued new regulations governing foreign law firms in China. A number of commentators have analyzed these regulations to evaluate whether China is "on track" to fulfilling the commitments it undertook to gain entry to the WTO. However, a more basic question that should be addressed is whether the new regulations meet China's goals in joining the WTO: to foster trade and economic development and to accelerate the growth of China's legal profession.

Although China appeared willing to engage in significant liberalization of the legal services sector when it joined the WTO, the new regulations reflect a much more cautious approach in recognition of the vulnerability of Chinese law firms to foreign competition. On one hand, the regulations shield an infant domestic industry from competition in spheres of activity where Chinese law firms already dominate, while, on the other hand, they favor the expansion into China of some of the largest foreign firms in the world by erecting costly barriers to entry that deter entry by smaller foreign firms. As China's market for legal services expands, and the demand for legal expertise in complex commercial transactions grows, Chinese firms, which lack a deep pool of attorneys experienced in commercial transactions, are likely to be squeezed out of the transactional segment of the market by larger, more efficient foreign firms. China's approach in adopting the new regulations fails to recognize the benefits of competition and the regulations should therefore be revised. By lowering barriers to entry and permitting free interaction between Chinese and foreign lawyers, China can accelerate the development of its legal services sector and continue to sustain high levels of economic growth.

### I. INTRODUCTION

The accession of the People's Republic of China ("China") to the World Trade Organization ("WTO") on December 11, 2001, after nearly fifteen years of negotiations, was a historic step toward free trade on a truly global scale.<sup>1</sup> China's accession package was the most complicated and lengthy accession agreement by any WTO member ("Member") to date.<sup>2</sup>

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<sup>†</sup> The author would like to thank Professor Donald Clarke and the *Pacific Rim Law & Policy Journal* staff for their valuable comments.

<sup>1</sup> See Press Release, World Trade Organization, WTO Ministerial Approves China's Accession (Nov. 10, 2001), available at [http://www.wto.org/english/news\\_e/pres01\\_e/pr252\\_e.htm](http://www.wto.org/english/news_e/pres01_e/pr252_e.htm) (last visited Apr. 30, 2003). See, e.g., Charlene Barshefsky, *Enter China: WTO Membership has Important Potential*, WASH. POST, Nov. 9, 2001, at A37, available at LEXIS, News Group File; Paul Blustein & Clay Chandler, *WTO Approves China's Entry; Move Expected to Speed Beijing's Transition to Capitalism*, WASH. POST, Nov. 11, 2001, at A47, available at LEXIS, News Group File; Press Release, European Union, China in WTO: Lamy Hails China's Accession Greatest Leap in History of Organisation (Nov. 10, 2001), available at [http://europa.eu.int/comm/trade/bilateral/china/pr121101\\_en.htm](http://europa.eu.int/comm/trade/bilateral/china/pr121101_en.htm) (last visited Apr. 30, 2003).

<sup>2</sup> William Abnett, *China and Compliance With World Trade Organization Commitments: The First Six Months*, in NATIONAL BUREAU OF ASIAN RESEARCH SPECIAL REPORT NO. 3: CHINA'S WTO ACCESSION: THE ROAD TO IMPLEMENTATION 6-7 (Nov. 2002).

The agreement includes over 600 commitments, not including tariff bindings, covering the full range of China's international trade relations, from trade in goods and services to protection of intellectual property.<sup>3</sup>

In the area of legal services, China's specific commitments under the General Agreement on Trade in Services ("GATS")<sup>4</sup> seemed to offer the promise of a new legal landscape in China, one in which foreign firms could form joint legal ventures with domestic firms and open multiple offices in every commercial hub in China.<sup>5</sup> However, as China has taken steps to bring its legal system into compliance with its WTO commitments,<sup>6</sup> it has also faced tremendous internal pressure to slow the pace of liberalization.<sup>7</sup> In the case of legal services, it appears that protectionist sentiments have influenced the formulation of China's new regulations on the provision of legal services in China by foreign law firms.<sup>8</sup> Thus, just a year after its accession to the WTO, China's ability and willingness to fulfill its commitments with respect to the legal services sector are being questioned.<sup>9</sup>

While the question of whether China is meeting its commitments under the GATS is one that has interested a number of commentators,<sup>10</sup> a more fundamental question is whether the new regulations will meet the Chinese government's objectives: to foster economic growth and promote

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<sup>3</sup> *Id.*

<sup>4</sup> General Agreement on Trade in Services, Apr. 15, 1994, Marrakesh Agreement Establishing the World Trade Organization, Annex 1B, LEGAL INSTRUMENTS - RESULTS OF THE URUGUAY ROUND vols. 28-30, 33 I.L.M. 1168 (1994) [hereinafter GATS], available at [http://www.wto.org/english/docs\\_e/legal\\_e/26-gats.pdf](http://www.wto.org/english/docs_e/legal_e/26-gats.pdf) (last visited Apr. 30, 2003). The GATS was concluded as part of the Uruguay Round to bring world trade in services within a legal framework broadly analogous to that governing trade in goods. JOHN H. JACKSON ET AL., LEGAL PROBLEMS OF INTERNATIONAL ECONOMIC RELATIONS 853-854 (4th ed. 2002).

<sup>5</sup> *China's Entry to WTO Opens up Joint Venture Opportunities*, LAWYER (Oct. 15, 2001), available at 2001WL 11473564.

<sup>6</sup> According to the Minister of Foreign Trade and Economic Cooperation, China has "abolished or revised as many as some 2300 laws and regulations related to foreign trade and economic cooperation to meet the WTO standards." Press Release, Ministry of Foreign Trade and Economic Cooperation, Five Positive Changes for China's Opening to Outside World (Nov. 14, 2002), available at [http://english.moftec.gov.cn/article/200211/20021100050256\\_1.xml](http://english.moftec.gov.cn/article/200211/20021100050256_1.xml) (last visited Apr. 30, 2003).

<sup>7</sup> *See Experts: Post WTO Chinese Lawyers Must Improve to Follow Global Criteria*, XINHUA GEN. NEWS SERVICE, Dec. 29, 2002, LEXIS, News Group File.

<sup>8</sup> *See* David Murphy, *Fencing in the Foreign Lawyers*, FAR E. ECON. REV., Aug. 29, 2002, at 26, 2002 WL-FEER 24511843.

<sup>9</sup> *See, e.g.*, UNITED STATES TRADE REPRESENTATIVE, 2002 REPORT TO CONGRESS ON CHINA'S WTO COMPLIANCE 44 (Dec. 11, 2002) [hereinafter USTR, 2002 REPORT TO CONGRESS], available at [http://www.ustr.gov/regions/china-hk-mongolia-taiwan/2002-12-11-China\\_WTO\\_compliance\\_report.PDF](http://www.ustr.gov/regions/china-hk-mongolia-taiwan/2002-12-11-China_WTO_compliance_report.PDF) (last visited Apr. 30, 2003).

<sup>10</sup> *See, e.g.*, Murphy, *supra* note 8 (suggesting that the regulations go against the spirit, if not the substance, of China's WTO commitments); USTR, 2002 REPORT TO CONGRESS, *supra* note 9, at 44 (commenting that new regulations raise concerns about compliance).

the development of domestic legal services providers.<sup>11</sup> Because the regulations reflect China's potentially conflicting goals of protecting an infant domestic legal services industry while fostering economic growth, they may produce some unintended results. On one hand, they attempt to protect domestic services providers from competition in spheres of activity where Chinese firms already dominate. On the other hand, however, the regulations facilitate the expansion into China of some of the largest—and arguably most efficient—foreign firms in the world. Instead of protecting Chinese firms, these trends may combine to squeeze Chinese firms out of new and growing areas of the market for legal services. Therefore, this Comment concludes that the regulations are not serving their intended purpose and should be revised.

Part II of this Comment provides a historical overview of the legal services sector in China to illustrate why China's domestic legal services providers have sought protection from foreign competition. Part III reviews the commitments China made under the GATS with respect to legal services. Part IV examines the regulations promulgated by the Chinese government to implement its GATS commitments. Part V analyzes how the new regulations are likely to affect competition in and the development of China's legal services sector. Part VI concludes that increased competition is the key to accelerating the development of China's legal services sector while sustaining economic growth, and provides some recommendations on how the regulations may be better calibrated to achieve these goals.

## II. CHINA'S LEGAL PROFESSION HAS MADE GREAT STRIDES IN RECENT YEARS BUT REMAINS VULNERABLE TO COMPETITION FROM FOREIGN LAW FIRMS

The history of the legal profession in China explains why the legal profession in China is underdeveloped today and why the Chinese government is hesitant to fully liberalize the legal services sector in China. Lawyers in China have endured a history of persecution and have only recently begun to grow in numbers. Indeed, Chinese cultural and political attitudes towards the legal profession did not begin to shift until the late

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<sup>11</sup> See, e.g., Xiao Hongming, *The Internationalization of China's Legal Services Market*, 1 PERSPECTIVES (June 30, 2000) at [http://www.oycf.org/Perspectives/6\\_063000/internationalization\\_of\\_china.htm](http://www.oycf.org/Perspectives/6_063000/internationalization_of_china.htm) (last visited Apr. 30, 2003); Amy Sommers, *One Year After China's WTO Accession: Is the Glass Half Empty or Half Full? A Discussion of the Successes and Challenges of China's WTO Entry*, in *The World Trade Organization: Recent Developments* (Feb. 7, 2003) (unpublished A.B.A. Sec. Int'l L. & Prac. meeting materials) (on file with author).

1970s. Thus, Chinese law firms are generally at a competitive disadvantage to their foreign counterparts.

*A. China's Historically Persecuted Legal Profession Makes a Dramatic Recovery*

A review of the political and cultural context of the practice of law in traditional China provides a basis for understanding why the legal profession in China is underdeveloped today. As one scholar has observed, "[t]raditional China held neither law nor lawyers in high esteem,"<sup>12</sup> and traditional attitudes toward the law that caused the populace to "avoid and fear involvement with formal legal institutions" were reinforced more recently during decades of Communist rule.<sup>13</sup> The private practice of law was banned in China in 1949, then briefly permitted from 1954 to 1957, and was not revived again until the death of Chairman Mao Zedong in 1976.<sup>14</sup> During this time, lawyers "were condemned as the worst of that 'stinking ninth category' of antisocial elements called intellectuals."<sup>15</sup>

Beginning in 1957, with the advent of the Anti-Rightist Campaign, and later, during the Cultural Revolution, lawyers were persecuted and their offices shut down.<sup>16</sup> Many lawyers were executed or sent to labor camps.<sup>17</sup> Law schools were closed from 1967 to 1978<sup>18</sup> and the few professors who remained at law departments changed professions or discontinued their research and teaching.<sup>19</sup> By the late 1970s, only a few thousand lawyers remained in China.<sup>20</sup>

With Mao's death and Deng Xiaoping's assumption of the chairmanship of the Communist Party in 1978, the legal profession experienced a political revival.<sup>21</sup> The rehabilitation of the legal profession

<sup>12</sup> RANDALL PEERENBOOM, CHINA'S LONG MARCH TOWARD RULE OF LAW 345 (2002) [hereinafter PEERENBOOM, CHINA'S LONG MARCH].

<sup>13</sup> See generally Stanley Lubman, *Bird in a Cage: Chinese Law Reform After Twenty Years*, 20 NW. J. INT'L L. & BUS. 383, 405-06 (2000); Shen Zongling, *The Role of Lawyers in Social Change: China*, 25 CASE W. RES. J. INT'L L. 163, 167 (1993).

<sup>14</sup> See, e.g., VICTOR H. LI, LAW WITHOUT LAWYERS: A COMPARATIVE VIEW OF LAW IN CHINA AND IN THE UNITED STATES 22-24 (1978); PEERENBOOM, CHINA'S LONG MARCH, *supra* note 12, at 346-48.

<sup>15</sup> Jerome A. Cohen, *Reforming China's Civil Procedure: Judging the Courts*, 45 AM. J. COMP. L. 793, 793 (1997).

<sup>16</sup> PEERENBOOM, CHINA'S LONG MARCH, *supra* note 12, at 347.

<sup>17</sup> LASZLO LADANY, LAW AND LEGALITY IN CHINA 33 (Marie-Luise Nath ed., 1992)

<sup>18</sup> Lubman, *supra* note 13, at 389.

<sup>19</sup> Jianfan Wu, *Building New China's Legal System*, in CHINA'S LEGAL DEVELOPMENT 38 (John R. Oldham ed., 1986).

<sup>20</sup> PEERENBOOM, CHINA'S LONG MARCH, *supra* note 12, at 361.

<sup>21</sup> Jerome A. Cohen, *The Chinese Legal System: A Primer for Investors*, 17 N.Y.L. SCH. J. INT'L & COMP. L. 345, 346 (1997).

under Mao's successor, Deng Xiaoping, was seen as essential to the success of Deng's economic and political reforms.<sup>22</sup> Deng estimated that China would need between 100,000 and 200,000 lawyers to meet the demands of his reforms.<sup>23</sup> For example, lawyers were needed to draft the legislation required to transform China from a centrally planned economy into a more market-oriented economy.<sup>24</sup> Lawyers were also needed to create a legal structure that would allow China to join the international economy.<sup>25</sup>

Once the government had decided that the legal profession was no longer taboo, the rebuilding of the legal profession began in earnest. Recognizing the urgent need for more lawyers, the Chinese government responded by requesting all provinces and cities to reopen college and university law departments and set up training programs to train cadres and develop specialized legal talent.<sup>26</sup> Simultaneously, in 1980, the National People's Congress ("NPC") passed the Provisional Regulations on Lawyers.<sup>27</sup> The Provisional Regulations on Lawyers were intended to promote the rapid growth of the legal profession with minimal qualifications and an application process that emphasized political criteria and practice.<sup>28</sup> Initially, lawyers were not required to pass a bar examination.<sup>29</sup> The Ministry of Justice ("MOJ") did not institute China's first national bar exam until 1986.<sup>30</sup> By 1994, more than 400,000 individuals had taken the exam, and some 78,000 had passed.<sup>31</sup> In addition, law school enrollment has increased significantly. In 2001 alone, there were 61,474 graduates and 146,782 new enrollees in college and specialized law programs.<sup>32</sup>

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<sup>22</sup> *Id.* at 347.

<sup>23</sup> RANDALL PEERENBOOM, *LAWYERS IN CHINA: OBSTACLES TO INDEPENDENCE AND THE DEFENSE OF RIGHTS* 17 (1998) [hereinafter PEERENBOOM, *LAWYERS IN CHINA*].

<sup>24</sup> See, e.g., Cohen, *supra* note 21, at 347.

<sup>25</sup> See *id.* at 347-48.

<sup>26</sup> Wu, *supra* note 19, at 39.

<sup>27</sup> PEERENBOOM, *CHINA'S LONG MARCH*, *supra* note 12, at 348; William P. Alford, *Tasselled Loafers for Barefoot Lawyers: Transformation and Tension in the World of Chinese Legal Workers*, 141 *CHINA Q.* 22, 28 (1995) [hereinafter Alford, *Chinese Legal Workers*].

<sup>28</sup> PEERENBOOM, *CHINA'S LONG MARCH*, *supra* note 12, at 348.

<sup>29</sup> *Id.*

<sup>30</sup> Alford, *Chinese Legal Workers*, *supra* note 27, at 31.

<sup>31</sup> PEERENBOOM, *LAWYERS IN CHINA*, *supra* note 23, at 39.

<sup>32</sup> NAT'L BUR. OF STATISTICS OF CHINA, *CHINA STAT. Y.B.* 677 (2002). These figures represent a twenty-eight percent increase in the number of enrollees and a thirty-nine percent increase in the number of graduates since 2000. *Id.*

B. *Chinese Legal Services Providers Are Not Yet Competitive With Their Foreign Counterparts*

While the revival of the legal profession in China in the last two decades has been a tremendous achievement, China's legal services providers are not yet competitive with their foreign counterparts in a number of areas. The Chinese government has therefore adopted a highly cautious approach to liberalization of the legal services sector.

One area of weakness in the Chinese legal services sector is the shortage of lawyers China continues to face. China has an estimated 120,000 lawyers<sup>33</sup> and over 9500 domestic law firms,<sup>34</sup> most of which are state-run.<sup>35</sup> On a per capita basis, however, the number of lawyers in China is extremely low.<sup>36</sup> Thus, lawyers represent clients in only ten to twenty-five percent of civil and economic cases, and only about four percent of registered Chinese businesses have regular legal advisors.<sup>37</sup>

The emphasis on rapid growth of the legal profession also came with some compromises in quality. Under the Provisional Regulations on Lawyers, an individual could apply to be a lawyer on the basis of minimal formal education or on-the-job training, love for China, support for the

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<sup>33</sup> *Roundtable Before the Congressional-Executive Commission on China*, 107th Cong. 34 (2002) (statement of Jerome A. Cohen, Professor, New York University School of Law), <http://www.cecc.gov/pages/roundtables/072602/index.php> (last visited Apr. 30, 2003); ZHONG GUO FALU NIAN JIAN [LAW Y.B. OF CHINA] 1272 (2001). Of the 117,260 lawyers in China, only 69,117 hold law degrees (*zhuanzhi lushi*) and 15,639 are part-time lawyers (*jianzhi lushi*). *Id.* The Chinese system of "part-time lawyers" is discussed in Henry Zheng, *The Evolving Role of Lawyers and Legal Practice in China*, 36 AM. J. COMP. L. 473, 492-93 (1988). The Chinese government has set a target of 300,000 lawyers by 2010. William P. Alford, *A Second Great Wall? China's Post-Cultural Revolution Project of Legal Construction*, 11 CULT. DYNAMICS 193, 195 (1999) [hereinafter Alford, *A Second Great Wall*].

<sup>34</sup> See LAW Y.B. OF CHINA, *supra* note 33, at 1272.

<sup>35</sup> Lubman, *supra* note 13, at 389.

<sup>36</sup> See *id.* In 2000, China's 117,260 lawyers represented .009% of the population of Mainland China, or approximately the equivalent of one lawyer per 11,000 people. See LAW Y.B. OF CHINA, *supra* note 34, at 1272. In comparison, lawyers represent .32% of the population in the U.S. and .09% in West Germany. PEERENBOOM, CHINA'S LONG MARCH, *supra* note 12, at 362. According to 1990 census figures, the U.S. had 779,471 lawyers and judges for a total population less than one quarter the size of China's. U.S. Census Bureau, *Historical Statistic Abstract: Detailed Occupation by Race, Hispanic Origin and Sex*, in CENSUS 1990, <http://censtats.census.gov/cgi-bin/eeo/eeojobs.pl> (last visited Apr. 30, 2003). As of August 2002, Hong Kong had nearly 6000 solicitors and barristers with a total population of 7.3 million. Hong Kong Trade Development Council, *Profiles of Hong Kong Major Service Industries*, <http://www.tdctrade.com/main/si/splega.htm> (last visited Apr. 30, 2003); U.S. Census Bureau, International Data Base, *Countries Ranked by Population: 2002*, <http://www.census.gov/ipc/www/idbrank.html> (last visited Apr. 30, 2003).

<sup>37</sup> A.B.A. China Law Committee, Written Comments on Rule of Law Issues Related to the People's Republic of China's Accession to the World Trade Organization, in *The World Trade Organization: Recent Developments* (Feb. 7, 2003) (unpublished A.B.A. Sec. Int'l L. & Prac. meeting materials) (on file with author).

socialist system, and eligibility to vote and stand for election.<sup>38</sup> Even after the institution of a national bar examination in 1986, quality issues persisted such that a decade later, barely one-fifth of Chinese lawyers had earned university law degrees.<sup>39</sup> Another impediment to the improvement of the quality and professionalism of the legal work force in China has been the absence of good role models.<sup>40</sup> Because the revival of the legal services sector in China is still relatively recent, “[u]nlike other countries, where young lawyers work side by side with experienced senior lawyers, China’s lawyers to a considerable extent have had to figure out for themselves what it means to be a lawyer.”<sup>41</sup>

Another weakness of Chinese legal services providers is their lack of independence or autonomy.<sup>42</sup> Because the Provisional Regulations on Lawyers defined lawyers as workers of the state, the legal profession was not self-regulating.<sup>43</sup> However, some progress has been made in this area. The non-governmental All China Lawyers’ Association (“ACLA”) was formed in 1986 to represent the legal profession and, beginning in 1988, the government permitted the organization of non-state-owned law firms.<sup>44</sup> Furthermore, the MOJ has begun to transition from its role as a regulator into that of a “macro-administrative” entity, regulating the profession at the macro level rather than on a day-to-day basis.<sup>45</sup> Since the 1996 enactment of the Lawyers Law, Chinese lawyers have largely been free to choose their own cases and to run their law practices as quasi-businesses.<sup>46</sup> Despite this progress, the independence of the legal profession is still limited by the institutional weakness of bar associations, including the ACLA, and the government’s desire to control autonomous social organizations.<sup>47</sup>

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<sup>38</sup> PEERENBOOM, CHINA’S LONG MARCH, *supra* note 12, at 348.

<sup>39</sup> See Alford, *Chinese Legal Workers*, *supra* note 27, at 31.

<sup>40</sup> PEERENBOOM, CHINA’S LONG MARCH, *supra* note 12, at 366.

<sup>41</sup> *Id.* Professor Peerenboom remarks that “in many firms, little time is spent training junior associates. Further, in making partnership and salary decisions, an associate’s ability to generate new clients is often more important than the quality of service or the associate’s legal skills.” *Id.* This emphasis on rainmaking and the huge disparity between compensation of associates and partners discourages associates from developing their legal skills and those associates who are qualified are also likely to leave to start their own firms. This, in turn, contributes to continuity and depth problems. *Id.*

<sup>42</sup> The establishment of a competent and independent legal profession is one of the cornerstones of rule of law. PEERENBOOM, CHINA’S LONG MARCH, *supra* note 12, at 343-44.

<sup>43</sup> Shen, *supra* note 13, at 167.

<sup>44</sup> See Timothy A. Gelatt, *Lawyers in China: The Past Decade and Beyond*, 23 N.Y.U. J. Int’l L. & Pol. 751, 789 (1991); Alford, *Chinese Legal Workers*, *supra* note 27, at 31.

<sup>45</sup> Alford, *Chinese Legal Workers*, *supra* note 27, at 31.

<sup>46</sup> Note, *Class Action Litigation in China*, 111 HARV. L. REV. 1523, 1536 (1998).

<sup>47</sup> PEERENBOOM, CHINA’S LONG MARCH, *supra* note 12, at 371-72. Even the former secretary general of the All China Lawyer’s Association has conceded that China’s bar associations are not up to the task of regulating the legal profession. *Id.* at 372.



Finally, beyond issues of competence and independence, perhaps the most troubling weakness of Chinese legal services providers lies in the area of professional responsibility. These problems range from bribery of officials and judges to more subtle issues of conflict of interest involving the maintenance of quasi-monopolies benefiting law firms in which regulators or former regulators have a pecuniary interest or are otherwise associated.<sup>48</sup>

### C. *China Cautiously Opens Its Doors to Foreign Lawyers*

Recognizing the relative weakness of Chinese legal services providers, the Chinese government has exhibited a great deal of reluctance to liberalize the Chinese legal services market, opening the market only to the extent necessary to maintain tight control on market access. Thus the government officially opened its doors to foreign law firms in 1992,<sup>49</sup> but only after a number of foreign law firms had already established representative offices beginning in the mid-to-late 1980s.<sup>50</sup> These firms circumvented the official ban by using a variety of creative techniques, such as setting up representative offices in the name of a client or registering as a consulting firm.<sup>51</sup> A former MOJ official has acknowledged that the opening of the legal services market in 1992 was necessary "to meet the demands of economic development and legal exchange" and that the MOJ was forced to pay attention to this issue after an "influx of foreign 'consulting firms.'"<sup>52</sup>

In 1992, the MOJ and the State Administration for Industry and Commerce ("SAIC") began to approve foreign law firms on a trial basis under the Provisional Regulations on the Setting up of Offices by Foreign Law Firms within the Territory of China ("Provisional Foreign Law Firm Regulations").<sup>53</sup> Under the Provisional Foreign Law Firm Regulations,

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<sup>48</sup> Alford, *Chinese Legal Workers*, *supra* note 27, at 33. See also PEERENBOOM, CHINA'S LONG MARCH, *supra* note 12, at 367-69 (listing accusations against lawyers including bribery, falsification of evidence, and payment of kick-backs or "fees" for client referrals).

<sup>49</sup> PEERENBOOM, LAWYERS IN CHINA, *supra* note 23, at 36; Yujie Gu, Note, *Entering the Chinese Legal Market: A Guide for American Lawyers Interested in Practicing Law in China*, 48 DRAKE L. REV. 173, 196 (1999).

<sup>50</sup> PEERENBOOM, LAWYERS IN CHINA, *supra* note 23, at 36.

<sup>51</sup> See Xiao, *supra* note 11 (describing how Coudert Brothers established a permanent presence in Beijing as "in-house counsel" to its clients while providing legal services under its own name). Mr. Xiao states that under a regulation permitting the establishment of foreign trade consultancies, Coudert Brothers LLP; Baker & McKenzie; Paul, Weiss, Rifkind, Wharton & Garrison LLP; and several British firms incorporated consulting firms and then set up subsidiaries in Beijing or Shanghai to provide legal services. *Id.* By 1989, he reports that over twenty "consulting firms" had been established by foreign law firms. *Id.*

<sup>52</sup> *Id.*

<sup>53</sup> Ministry of Justice & State Administration for Industry and Commerce, Provisional Regulations on the Setting Up of Offices by Foreign Law Firms Within the Territory of China, Judiciary Document No.

foreign law firms could not employ Chinese lawyers, interpret Chinese law or form joint ventures with Chinese firms.<sup>54</sup> Chinese lawyers employed by foreign law firms were required to surrender their licenses.<sup>55</sup> Furthermore, foreign law firms were initially restricted to Beijing, Shanghai, Guangzhou, Hainan and Shenzhen<sup>56</sup> although ten more cities were added to the list in 1994.<sup>57</sup> Finally, foreign law firms were only permitted to open a single office in one city<sup>58</sup> and were prohibited from engaging in legal service activities “in the name of consultants, business companies, etc.”<sup>59</sup>

Despite these restrictions, foreign law firms were eager to enter the Chinese market.<sup>60</sup> In December 1992, out of over one hundred foreign firms that applied,<sup>61</sup> twelve were approved to begin operations in Beijing, Guangzhou and Shanghai.<sup>62</sup> In the summer of 2000, the Vice Minister of Justice announced that the “one firm, one office” rule would soon be abolished.<sup>63</sup> By April 2001, 103 foreign firms had been authorized to open

004 (May 26, 1992) [hereinafter Provisional Regulations on Foreign Law Firms], [http://www.info.gov.hk/justice/new/depart/doc/setupLaw\\_firm\\_e.pdf](http://www.info.gov.hk/justice/new/depart/doc/setupLaw_firm_e.pdf) (last visited Apr. 30, 2003).

<sup>54</sup> See *id.* arts. 16-17.

<sup>55</sup> *Id.* art. 17.

<sup>56</sup> Ministry of Justice, *Notice Regarding the Printing and Distribution of “Operational Rules for the Examination, Approval and Administration of Foreign Law Firm Representative Offices,”* (May 26, 1992), <http://www.isinolaw.com>.

<sup>57</sup> The ten cities are Ningbo, Tianjin, Dalian, Qingdao, Yantai, Hangzhou, Fuzhou, Suzhou, Xiamen, and Zhuhai. PEERENBOOM, *LAWYERS IN CHINA*, *supra* note 23, at 37.

<sup>58</sup> However, many firms did not strictly follow the regulations and set up one or more unlicensed law offices. Ann Davis, *Shanghai Exit for Coudert*, NAT'L L.J., Jan. 30, 1995, LEXIS, News Group File. In 1995, Coudert Brothers LLP and Baker & McKenzie were later forced to dismantle their Shanghai offices under pressure from the Chinese government. *Id.* Both firms had licenses to operate in Beijing, but not in Shanghai. *Id.* Freshfields Bruckhaus Deringer LLP had unlicensed offices in both Shanghai and Beijing. *Id.* At least one firm openly claims to have six offices in China, with a seventh office in Hong Kong. See Brand, Farrar & Buxbaum LLP, at <http://www.attorney.net.cn/southcn/shenzhenbf.htm> (last visited Apr. 30, 2003). Brand Farrar is listed under the name of Anderson & Anderson LLP in the Martindale-Hubbell Law Directory. *Anderson & Anderson*, LEXIS, Martindale-Hubbell Law Directory Listings. However, this firm is not on the MOJ's list of foreign law firms licensed to practice in China. Ministry of Justice Notice No. 11, Oct. 23, 2002, LEXIS, China & Hong Kong Library, ChinaLawInfo Selected PRC Laws Files, PRCLEG 2517 [hereinafter Notice No. 11] (Foreign Firms approved to practice in Mainland China).

<sup>59</sup> Provisional Regulations on Foreign Law Firms, *supra* note 53, art. 3.

<sup>60</sup> See Victoria Slind-Flor, *China's Riches Lure Lawyers*, NAT'L L.J., Nov. 29, 1993, LEXIS, News Group File.

<sup>61</sup> *Id.*

<sup>62</sup> *Foreign Lawyers Licensed in China*, XINHUA NEWS AGENCY, Oct. 26, 1992, 1992 WL 11228276; Cao Yong, *Door Opens to Foreign Lawyers*, CHINA DAILY, Nov. 2, 1992, 1992 WL 8729374. U.S.-based Coudert Brothers LLP, U.K.-based Denton Hall (now Denton Wilde Sapte), U.K.-based Lovell White Durrant (now Lovells), and the French firm, Adamas, were the only four non-Hong Kong-based law firms authorized in 1992. See Ministry of Justice Notice No. 10, Oct. 23, 2002, LEXIS, China & Hong Kong Library, ChinaLawInfo Selected PRC Laws Files, PRCLEG 2516 [hereinafter Notice No. 10] (Hong Kong and Macao firms approved to practice in Mainland China); Notice No. 11, *supra* note 58. All four firms authorized to practice in Shanghai were based in Hong Kong. See Notice No. 10, *supra*.

<sup>63</sup> NICHOLAS LARDY, *INTEGRATING CHINA INTO THE GLOBAL ECONOMY* 145 (2002). Lardy writes that the lifting of the one city restriction is important:

resident offices in China, with an additional twenty-eight branch offices of Hong Kong law firms.<sup>64</sup> As China's entry into the WTO approached, expectations were high for a significant liberalization of the legal sector.

### III. CHINA'S COMMITMENTS UNDER THE GATS HINTED THAT LIBERALIZATION OF THE LEGAL SERVICES SECTOR WAS IMMINENT

By the time the WTO Ministerial Conference approved the text of the agreement on China's entry into the WTO at Doha, the terms of its commitments under the GATS in the area of legal services had been negotiated in excruciating detail through bilateral accession agreements with major trading partners such as the United States and the European Union ("EU").<sup>65</sup> A review of China's Schedule of Specific Commitments ("Schedule") under the GATS provides a basis for understanding China's new foreign law firm regulations, which incorporate these commitments into Chinese law.

#### A. *The Framework of the General Agreement on Trade in Services: The Importance of Sector-Specific Commitments*

The purpose of the GATS is to expand global trade in services<sup>66</sup> by bringing trade in services within a legal framework analogous to the General

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Since a large share of the work of foreign law firms is advising companies on joint venture investments, permitting offices in more than one city is important. It means that foreign law firms will no longer have to choose between operating in Beijing, where all large-scale projects must be approved, or in Shanghai, China's emerging finance and banking center. For the first time they will be able to maintain offices in both or any other combination of cities that facilitates their ability to serve their clients.

*Id.*

<sup>64</sup> *Foreign Law Firms Set Up 103 Offices in China*, XINHUA NEWS AGENCY, Apr. 12, 2001, 2001 WL 19106343.

<sup>65</sup> Compare U.S.-China Market Access Agreement, concluded Nov. 15, 1999, as released by the United States Trade Representative on Mar. 14, 2000, at 6, <http://www.uschina.org/public/wto/market/162-182.pdf> (last visited Apr. 30, 2003) and Sino-E.U. Agreement on China's Accession to the WTO: Results of the Bilateral Negotiations, concluded May 19, 2000 [hereinafter Sino-E.U. Agreement], [http://www.delchn.cec.eu.int/en/eu\\_china\\_wto/wto7.htm](http://www.delchn.cec.eu.int/en/eu_china_wto/wto7.htm) (last visited Apr. 30, 2003) with World Trade Organization, *Protocol on the Accession of the People's Republic of China, Annex IX. Schedule of Specific Commitments on Services List of Article II MFN Exemption*, WT/ACC/CHN/49/Add.2 5 (Nov. 10, 2001) [hereinafter Schedule of Specific Commitments], <http://docsonline.wto.org/DDFDocuments/t/WT/ACC/CHN49A2.doc> (last visited Apr. 30, 2003). For an interesting discussion of the Chinese perspective on the negotiations as described by an MOJ official, see Xiao, *supra* note 11.

<sup>66</sup> The preamble of the agreement states that the goal is "to establish a multilateral framework of principles and rules for trade in services with a view to the expansion of such trade under conditions of transparency and progressive liberalization and as a means of promoting the economic growth of all trading partners and the development of developing countries." GATS, *supra* note 4, pmb1.

Agreement on Tariffs and Trade ("GATT"),<sup>67</sup> which governs trade in goods.<sup>68</sup> Like the GATT, the GATS contains two types of obligations: those that apply generally to all measures affecting trade in services and those that are based on sector-specific commitments assumed by individual Members.<sup>69</sup> Together, they operate to "lock" Members into starting positions from which progressive rounds of negotiations can expand liberalization.<sup>70</sup>

General obligations under the GATS, which apply to all measures affecting trade in services, are derived from cornerstone principles of the GATT.<sup>71</sup> They include "transparency," which requires each Member to publish promptly "all relevant measures of general application" affecting trade in services, and the "most favored nation" ("MFN") principle, which prevents Members from discriminating among trading partners.<sup>72</sup>

The GATS obligations of "market access" and "national treatment," on the other hand, only apply to those sectors explicitly listed by a Member in its schedule of commitments.<sup>73</sup> The market access provision of the GATS prohibits six types of limitations: (1) limitations on the number of suppliers; (2) limitations on the total value of service transactions or assets; (3) limitations on the total number of service operations or on the total quantity of service output; (4) limitations on the total number of natural persons that may be employed; (5) measures which restrict or require specific types of legal entity or joint venture; and (6) limitations on the participation of foreign capital.<sup>74</sup> National treatment is defined under Article XVII as treatment no less favorable than that accorded to a similarly situated domestic services supplier.<sup>75</sup> Members may elect to place limitations on national treatment in their schedules with respect to any of the four modes of supply described below.<sup>76</sup>

The GATS recognizes that trade in intangible services is different from trade in tangible goods by defining "trade in services" as the supply of

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<sup>67</sup> General Agreement on Tariffs and Trade, Oct. 30, 1947, 61 Stat. A-11, T.I.A.S. 1700, 55 U.N.T.S. 194 [hereinafter GATT], [http://www.wto.org/english/docs\\_e/iegai\\_e/iegai\\_e.htm](http://www.wto.org/english/docs_e/iegai_e/iegai_e.htm) (last visited Apr. 30, 2003).

<sup>68</sup> JACKSON ET AL., *supra* note 4, at 853.

<sup>69</sup> *Id.*; AADITYA MATTOO, CHINA'S ACCESSION TO THE WTO: THE SERVICES DIMENSION 3 (World Bank Policy Research Working Paper No. 2932, 2002).

<sup>70</sup> JOHN H. JACKSON, THE WORLD TRADING SYSTEM 307 (1997).

<sup>71</sup> *Id.* at 307-08.

<sup>72</sup> MATTOO, *supra* note 69, at 3.

<sup>73</sup> *Id.*

<sup>74</sup> GATS, *supra* note 4, art. XVI.

<sup>75</sup> JACKSON ET AL., *supra* note 4, at 886; MATTOO, *supra* note 69, at 3.

<sup>76</sup> MATTOO, *supra* note 69, at 4.

a service through any of four modes. The “cross-border” mode of supply is analogous to trade in goods and arises when a service crosses a national border.<sup>77</sup> The “consumption abroad” mode of supply is utilized when the consumer travels to the territory of the service supplier.<sup>78</sup> The “commercial presence” mode of supply involves foreign direct investment, usually in the context of the establishment of a branch or subsidiary.<sup>79</sup> Finally, the “movement of individuals” mode of supply is utilized when independent service providers or employees of a multinational firm temporarily move to another country.<sup>80</sup>

Because trade in legal services implicates foreign direct investment and movement of individuals across national borders to a much greater degree than trade in goods, a Member’s specific commitments are more important than its general obligations under the GATS. Stated differently, without specific commitments, the GATS, although in principle embracing the entire services industry, remains an empty shell.<sup>81</sup>

*B. China’s Specific Commitments on the Legal Services Sector Focus on Commercial Presence of Legal Services Providers*

The only significant provisions of China’s sector-specific commitments on legal services concern China’s limitations on the commercial presence of legal services providers.<sup>82</sup> China placed no limitations on either the “cross-border” or “consumption abroad” modes of supply.<sup>83</sup> With respect to “movement of individuals,” China placed no additional restrictions beyond those contained under the “commercial presence” mode of supply. China’s “market access” and “national treatment” limitations on the commercial presence mode of supply are addressed in turn below.

*1. Market Access Limitations Promise the Elimination of Restrictions on Multiple Offices*

Under the “commercial presence” mode of supply, China’s Schedule maintains existing restrictions on the provision of legal services by foreign

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<sup>77</sup> *Id.* at 3.

<sup>78</sup> *Id.*

<sup>79</sup> *Id.*

<sup>80</sup> *Id.*

<sup>81</sup> Robert F. Taylor & Philippe Metzger, *GATT and Its Effect on the International Trade in Legal Services*, 10 N.Y. INT’L L. REV. 1, 23 (1997).

<sup>82</sup> Schedule of Specific Commitments, *supra* note 65, at 5-7.

<sup>83</sup> *Id.* at 6.

law firms, while promising to lift geographic and quantitative limitations on foreign law offices. For example, like the Provisional Regulations on Foreign Lawyers, the Schedule provides that, “[f]oreign law firms can provide legal services only in the form of representative offices” in specially designated cities.<sup>84</sup> The Schedule also states that, “[r]epresentative offices can engage in profit-making activities.”<sup>85</sup> Although the Schedule reiterates the Provisional Regulations limitation of one representative office, it also provides that “geographic and quantitative limitations will be eliminated within one year after China’s accession to the WTO.”<sup>86</sup>

In terms of the types of services foreign representative offices may provide, the Schedule departs from the approach of the Provisional Regulations, which listed both permitted and forbidden activities, and instead provides an exclusive list of permitted activities.<sup>87</sup> The Schedule provides that foreign representative offices are permitted to engage in the following business activities:

- (a) to provide clients with consultancy on the legislation of the country/region where the lawyers of the law firm are permitted to engage in a lawyer’s professional work, and on international conventions and practices;
- (b) to handle, when entrusted by clients of Chinese law firms, legal affairs of the country/region where the lawyers of the law firm are permitted to engage in lawyer’s professional work;
- (c) to entrust, on behalf of foreign clients, Chinese law firms to deal with the Chinese legal affairs;
- (d) to enter into contracts to maintain long-term entrustment relations with Chinese law firms for legal affairs;
- (e) to provide information on the impact of the Chinese legal environment.<sup>88</sup>

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<sup>84</sup> *Id.* at 5. Nineteen cities are the same as before, minus Hainan and with the addition of Haikou, Wuhan, Chengdu, Shenyang, and Kunming. *Id.*

<sup>85</sup> *Id.*

<sup>86</sup> *Id.*

<sup>87</sup> Compare Provisional Regulations on Foreign Law Firms, *supra* note 53, arts. 15-16 with Schedule of Specific Commitments, *supra* note 65, at 6. Under the Provisional Regulations, there was the very real possibility for law firms to engage in activities that were neither permitted nor forbidden. See *Provisional Foreign Regulations on Foreign Law Firms*, *supra* note 53, arts. 15-16. Under the Schedule of Specific Commitments, however, the listing of permitted activities implies that all other activities are forbidden. See Schedule of Specific Commitments, *supra* note 65, at 6.

<sup>88</sup> Schedule of Specific Commitments, *supra* note 65, at 6. This was apparently added after negotiations with the E.U. See U.S.-China Market Access Agreement, *supra* note 65.

The first three activities were already permitted under the Provisional Regulations, but the last two are new<sup>89</sup> and, therefore, significant.

While the Schedule explains that “[e]ntrustment allows the foreign representative office to directly instruct lawyers in the entrusted Chinese law firm, as agreed between both parties,”<sup>90</sup> the significance of provision (d) was not well understood. European Union negotiators understood this provision to mean that “arrangements with local law firms have been improved by allowing foreign firms directly to instruct individual Chinese lawyers in these firms. This will allow foreign firms to create a direct link with a Chinese lawyer of their choice, which may in practice be equivalent to full employment.”<sup>91</sup> Others concluded that “long-term entrustment” meant that joint ventures would be permitted.<sup>92</sup>

Provision (e), like provision (d), is highly ambiguous. Under the Provisional Regulations, foreign law firms could neither act as agents in handling Chinese legal business nor interpret Chinese law for their clients.<sup>93</sup> However, provision (e) seems to suggest there might be a gray area. The provision was apparently added after negotiations with the EU,<sup>94</sup> and EU negotiators believed it meant that “foreign law firms will, for the first time, be able to offer services on Chinese law. In particular they will be able to provide information to their clients on the Chinese legal environment.”<sup>95</sup>

In addition to the business scope provisions, the schedule includes a requirement that representatives of a foreign law firm be members of the bar of a WTO member and have practiced for no less than two years outside China.<sup>96</sup> This was an apparent concession by China because the experience requirement had previously been three years.<sup>97</sup> However, a chief representative must still be a partner or of equivalent rank and have practiced for no less than three years.<sup>98</sup>

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<sup>89</sup> See Provisional Regulations on Foreign Law Firms, *supra* note 53, art. 16.

<sup>90</sup> Schedule of Specific Commitments, *supra* note 65, at 6.

<sup>91</sup> See Sino-E.U. Agreement, *supra* note 65, at 4.

<sup>92</sup> See *China's Entry to WTO Opens up Joint Venture Opportunities*, *supra* note 5.

<sup>93</sup> See Provisional Regulations on Foreign Law Firms, *supra* note 53, art. 16.

<sup>94</sup> The provision does not appear in the U.S.-China accession agreement. Compare U.S.-China Market Access Agreement, *supra* note 65, with Sino-E.U. Agreement, *supra* note 65, at 4.

<sup>95</sup> See Sino-E.U. Agreement, *supra* note 65, at 4.

<sup>96</sup> Schedule of Specific Commitments, *supra* note 65, at 7.

<sup>97</sup> See Sino-E.U. Agreement, *supra* note 65, at 4.

<sup>98</sup> Schedule of Specific Commitments, *supra* note 65, at 7.

## 2. National Treatment Limitations Maintain Residency Requirements and Prohibit Hiring of Chinese Lawyers Overseas

The national treatment section of the “commercial presence” mode of supply is a mix of existing restrictions and new provisions. The Schedule specifies that, “[a]ll representatives shall be resident in China no less than six months each year.”<sup>99</sup> Furthermore, “[t]he representative office shall not employ Chinese national registered lawyers outside of China.”<sup>100</sup> Under the Provisional Regulations, foreign law firms could not employ Chinese lawyers.<sup>101</sup>

## IV. CHINA ISSUES NEW REGULATIONS THAT DEVIATE FROM ITS COMMITMENTS AND CREATE NEW BURDENS FOR FOREIGN LAW FIRMS

Only one month after the Doha meeting, the State Council promulgated the Regulations on Representative Offices of Foreign Law Firms in China (“Regulations”), thereby replacing the 1992 Provisional Foreign Law Firm Regulations.<sup>102</sup> The Regulations became effective on January 1, 2002.<sup>103</sup> On July 4, 2002, the MOJ, which was tasked with implementing the new regulations, published its Implementing Rules for the 2002 Foreign Law Firm Regulations (“Implementing Rules”), which were made effective as of September 1, 2002.<sup>104</sup>

Although the Regulations and Implementing Rules were promulgated shortly after China’s accession to the WTO, they appear to reflect a less favorable attitude on the part of the Chinese government toward liberalization of the legal services sector. This change may be explained in part by the lapse of time between bilateral negotiations of market access agreements and actual accession, as well as the tremendous internal pressure the Chinese government has faced from Chinese legal services providers who remain at a competitive disadvantage to foreign firms.

<sup>99</sup> *Id.* at 5.

<sup>100</sup> *Id.*

<sup>101</sup> Provisional Regulations on Foreign Law Firms, *supra* note 53, art. 17.

<sup>102</sup> Administration of Representative Offices of Foreign Law Firms in China Regulations, Dec. 22, 2001, State Council Order No. 338, *translated in* China Law Reference Service ref. no. 1400/2001.12.22 [hereinafter Regulations on Foreign Law Firms].

<sup>103</sup> *Id.*

<sup>104</sup> Implementing the “Administration of Representative Offices of Foreign Law Firms in China Regulations” Provisions, July 4, 2002, Ministry of Justice Order No. 73, *translated in* China Law Reference Service ref. no. 1440/2002.07.04 [hereinafter Implementing Rules on Foreign Law Firms].



Because most scholars agree that China's obligations under the GATS do not have "direct applicability" or a "self-executing effect,"<sup>105</sup> the GATS commitments are not binding on the Chinese government or courts in the absence of domestic legislation and regulations incorporating those obligations. Therefore, the key to understanding the implications of WTO accession for the legal services sector lies in a careful examination of the new Regulations.<sup>106</sup> The Regulations in turn are a general policy statement and should be read in conjunction with the Implementing Rules issued by the MOJ.<sup>107</sup> For example, the Regulations do not address with any level of specificity some of the most pressing questions raised by China's GATS commitments.<sup>108</sup> The Regulations provide few details concerning the application process for establishment of multiple resident representative

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<sup>105</sup> See John H. Jackson, *Status of Treaties in Domestic Legal Systems*, 86 AM. J. INT'L L. 310, 310-15 (1992) ("It is generally said that for the treaty rule to operate in the domestic legal system of a dualist state, there must be an 'act of transformation,' that is, a government action by that state incorporating the treaty norm into its domestic law."); Donald Clarke, *China's Legal System and the WTO: Prospects for Compliance*, 2 WASH. U. GLOBAL STUD. L. REV. 97, 99 (2003) ("In my view, as a practical matter, China's WTO obligations will not become part of its domestic law, binding on courts and government bodies, until the enactment of appropriate domestic legislation and regulations incorporating those obligations."). But see Wang Tieya, *The Status of Treaties in the Chinese Legal System*, 1 J. CHINESE & COMP. L. 1, 7 (1995) ("Since treaties are directly applicable internally, it is not necessary to enact domestic laws for their implementation . . .").

<sup>106</sup> However, "the treaty language usually has 'relevance' in interpreting the statutory language, under various theories of the domestic jurisprudence." Jackson, *supra* note 105, at 315.

<sup>107</sup> Perry Keller describes the Chinese legislative system as comprised of two different forms of legislative hierarchy. The one relevant to this Comment is:

[A] hierarchy of legislative categories, which can be simplified into three levels. Primary legislation stands at the top of this pyramid, just below the Constitution in legal authority. This type of legislation is often narrowly categorized as "falü," a term which is usually translated as "law" and hence gives rise to considerable confusion in foreign accounts of Chinese law. At the second legislative level, there are "fagui" which are issued in different forms by the State Council and the regional People's Congresses. Although the term "fagui" is usually translated as "regulations," there are in fact many other Chinese legislative terms which, out of a lack of English language alternatives, must also be translated as "regulations". This provides yet another source of confusion in the use of English language translations of Chinese law. Finally, at the tertiary level, there are "guizhang" which are issued in different forms by central government ministries and regional and local governments. This term is also commonly translated as "regulation".

Perry Keller, *Sources of Order in Chinese Law*, 42 AM. J. COMP. L. 711, 736 (1994).

Although tertiary rules cannot be directly enforced in the courts or be used as the basis for the imposition of fines or penalties, they have many law like characteristics for those who are required to obey their provisions. *Id.* They are enforced by the administrative bodies that issue them and, anecdotal evidence suggests that judges give considerable weight to them in deciding how to apply formal laws and regulations. *Id.*

<sup>108</sup> Huen Wong & Owen Cox, *Foreign Law Firms Set to Expand in China*, CHINA L. & PRAC., Mar. 2002.

offices.<sup>109</sup> Similarly, the Regulations do not take a position on what types of activities might constitute “providing information on the impact of the Chinese legal environment” or whether “entrustment” relationships can take the form of a joint venture.<sup>110</sup> The Implementing Regulations, however, address these provisions in greater detail.

*A. “Entrustment” Does Not Permit Joint Ventures*

With respect to “entrustment” arrangements, Article 15 of the Regulations merely restates the Schedule’s statement that “entrustment” means a representative office may make direct contact with lawyers of an entrusted Chinese law firm.<sup>111</sup> Although this definition was thought to be broad enough to encompass joint ventures, the Regulations do not provide any additional clarification.<sup>112</sup> However, Article 39 of the Implementing Rules specifically prohibits a representative office and its principal law firm from either investing directly or indirectly in Chinese law firms, entering into joint profit-sharing ventures with Chinese law firms or lawyers, setting up an associated office or stationing staff in Chinese law firms to engage in legal services, or managing, operating, controlling or owning an interest in the form of shares in Chinese law firms.<sup>113</sup>

*B. “Chinese Legal Affairs” is Defined to Prohibit Foreign Firms From Interacting with Government Entities and Providing Legal Opinions Involving Chinese Law*

Article 15 of the Regulations restates verbatim the Schedule’s list of permitted activities that do not involve “Chinese legal affairs.”<sup>114</sup> However, the Implementing Rules provide additional clarification on the types of services that must be “entrusted” to a Chinese law firm:

- (1) to be engaged in any litigation in China as a lawyer;
- (2) to give legal opinions or certifications for any specific issues in any contracts, agreements, articles of association, or other

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<sup>109</sup> *Id.*

<sup>110</sup> *Id.*

<sup>111</sup> Regulations on Foreign Law Firms, *supra* note 102, art. 15.

<sup>112</sup> *See id.*

<sup>113</sup> *Id.* art. 39. Professor Peerenboom explains that at least one MOJ official has acknowledged that foreign lawyers would not be permitted to sit for the bar exam and foreign firms would not be allowed to merge with Chinese firms “largely because of the possibility that foreign lawyers would then take an aggressive stance on political cases.” PEERENBOOM, CHINA’S LONG MARCH, *supra* note 12, at 370.

<sup>114</sup> Regulations on Foreign Law Firms, *supra* note 102, art. 15.

- written documents with respect to application of Chinese law;
- (3) to provide legal opinions or certifications for any acts or incidences with respect to application of Chinese law;
  - (4) to provide opinions or comments in the capacity of attorney in arbitration on the application of the Chinese law and on facts which involve the Chinese law;
  - (5) to go through, on behalf of its clients, any registration, change, application, filing or other procedures with any Chinese government authorities or any other organizations that are authorized by laws or regulations to carry out administrative functions.<sup>115</sup>

These provisions place new substantive limits on the business activities of foreign law firms. Interestingly, the Implementing Rules purport to prohibit interpretation or arbitration involving Chinese law not just in China, but in other countries as well. The Implementing Rules also prohibit foreign lawyers from interacting directly with Chinese government officials. Under the Provisional Regulations, lobbying or other interaction with government officials were not explicitly prohibited<sup>116</sup> and, in practice, foreign firms regularly advised clients on points of Chinese law, liaised with various government agencies, and represented their clients in arbitration.<sup>117</sup>

Article 33 of the Implementing Rules further limits the scope of activity of foreign law firms. It states that "providing information on the impact of the Chinese legal environment," one of the five permitted business activities under the GATS Schedule, does not extend so far as to permit representative law offices and lawyers to provide specific opinions on the application of the laws of China.<sup>118</sup> To ensure that foreign law firms do not circumvent this provision, the Regulations continue to ban the hiring of practicing Chinese lawyers and forbid paralegals employed by foreign law firms from providing Chinese legal services.<sup>119</sup>

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<sup>115</sup> Implementing Rules on Foreign Law Firms, *supra* note 104, art. 32.

<sup>116</sup> See Provisional Regulations on Foreign Law Firms, *supra* note 53, art. 16.

<sup>117</sup> PEERENBOOM, *LAWYERS IN CHINA*, *supra* note 23, at 37-38.

<sup>118</sup> Implementing Rules on Foreign Law Firms, *supra* note 104, art. 33.

<sup>119</sup> Regulations on Foreign Law Firms, *supra* note 102, art. 16.

C. *New "Genuine Need" Provision Restricts Circumstances in Which Foreign Law Firms May Open Additional Offices*

Chapter 2 of the Regulations, which deals with the establishment, change and cancellation of registration of resident representative offices, copies verbatim the market access limitations specified by China in its Schedule.<sup>120</sup> However, the Regulations also contain a requirement that a foreign law firm have a "genuine need" to establish a resident representative office in China.<sup>121</sup> When the Regulations were first published, this requirement was a source of some confusion because the term had not appeared in the Schedule and was not defined in the Regulations.<sup>122</sup>

The Implementing Rules provided some insight into how the MOJ intended to interpret the "genuine need" requirement. Article 4 of the Implementing Rules defines "genuine need" to be determined on the basis of the following:

- (1) the social and economic circumstances of the place where the representative office is proposed to be established;
- (2) the need for legal services in the place where the proposed representative office is to be established;
- (3) the scale, time of establishment, major business areas and specialist strengths, analysis on the prospect and future business development plan of the proposed representative offices; and
- (4) the restrictions by the laws and regulations of China on specific legal services or affairs.<sup>123</sup>

While extremely ambiguous and highly discretionary, this provision of the Implementing Rules suggests some factors that might be considered by the MOJ.

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<sup>120</sup> Regulations on Foreign Law Firms, *supra* note 102, ch. 2. For example, Article 7 requires that a representative lawyer shall have been a practicing lawyer for not less than two years outside of China and that the chief representative lawyer shall have practiced for a minimum of three years and hold a position equivalent to that of a partner in the foreign law firm. *Id.*

<sup>121</sup> Regulations on Foreign Law Firms art. 7.

<sup>122</sup> See Schedule of Specific Comments, *supra* note 65.

<sup>123</sup> Implementing Rules on Foreign Law Firms, *supra* note 104, art. 4.

D. *Three-Year Waiting Period For Additional Offices Imposes Delay for Some Foreign Firms*

Although China's commitment to lift geographic and quantitative limitations on foreign law offices was without a doubt the most significant provision of the Schedule, the Regulations simply did not address procedures for opening multiple offices. Article 10 of the Implementing Rules contains two requirements for setting up "additional" representative offices: (1) that the representative office "most recently" set up in China by the foreign firm have operated "for three years continuously"; and (2) that the representative offices already established have complied with the laws, regulations, and rules of China as well as the codes of conduct and practice for lawyers.<sup>124</sup> It is not clear whether the three-year waiting period applies only to the opening of a second office or whether the waiting period restarts with each additional office.<sup>125</sup> At minimum, the three-year waiting period constitutes a delay for foreign firms that are late-comers to China.

V. THE REGULATIONS AND IMPLEMENTING RULES ARE OVERLY PROTECTIVE

Just one year after China's accession to the WTO, the record is still too thin for any meaningful evaluation of the immediate impact of WTO accession on the legal services sector in China. However, the promulgation by the State Council and the MOJ of the Regulations and Implementing Rules reveals some clues as to the pace at which the Chinese government intends to pursue liberalization of the legal services sector. The MOJ's policy with respect to the legal services sector appears to be to "facilitate China's foreign trade and business as well as help the development of China's legal profession" by encouraging Chinese lawyers to cooperate with and learn from foreign counterparts, while simultaneously protecting Chinese lawyers "against a massive influx of foreign lawyers."<sup>126</sup> Consistent with this view, the Regulations and, in particular, the Implementing Rules do not appear to signal a dramatic shift in the Chinese government's policy on foreign competition in the legal services sector.

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<sup>124</sup> *Id.*

<sup>125</sup> The Implementing Rules use the term "*zuijin*," which literally means "most recent." See Implementing Rules on Foreign Law Firms, *supra* note 104, art. 10. This could be interpreted to mean a three-year waiting period between each new office, or a three-year waiting period for the first new office after the issuance of the implementing rules.

<sup>126</sup> See Xiao, *supra* note 11 (describing the need to protect domestic services providers).

Rather, viewed together, the content of the Regulations and Implementing Rules suggests a very cautious approach.

A. *The Regulations May Not Comply With China's Commitments Under the GATS*

Although the Regulations and Implementing Rules represent a significant revision of the Provisional Foreign Law Firm Regulations, there are a number of provisions which not only conflict with the express terms of China's specific commitments under the GATS, but add to the administrative burdens that existed under the Provisional Foreign Law Firm Regulations. In accordance with China's commitments under the GATS, the Regulations and Implementing Rules establish procedures whereby foreign law firms can open multiple offices, lower the experience requirements for foreign lawyers from three to two years, and permit foreign law firms to apply their knowledge of Chinese law in providing information on the impact of the Chinese legal environment on clients' businesses.<sup>127</sup> However, they also contain provisions that may not be consistent with China's commitments under the GATS. The most problematic of these are the precondition of a "genuine need" to open an office in China and the three-year waiting period between applications for additional offices because these conditions were not stated as limitations on the applicability of the core GATT principles of market access and national treatment under the GATS schedule.<sup>128</sup>

The requirement of a "genuine need" has been interpreted by the U.S. government as creating an economic needs test.<sup>129</sup> Economic needs tests appear in a variety of forms, depending on the country or service sector involved, and are commonly employed to favor domestic suppliers.<sup>130</sup> As defined by the Implementing Rules, the needs test is highly discretionary and could serve as both a geographic or quantitative restriction if, for example, the MOJ were to decide that Beijing and Shanghai—the two most attractive markets for foreign law firms—no longer had a "genuine need" for lawyers.

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<sup>127</sup> See discussion *supra* Part III.B.

<sup>128</sup> See Schedule of Specific Commitments, *supra* note 65, at 5-6.

<sup>129</sup> See USTR, 2002 REPORT TO CONGRESS, *supra* note 9, at 44. An economic needs test may be defined as "a provision in national regulations, legislation or administrative guidelines [that] imposes a test that has the effect of restricting the entry of service suppliers on the basis of an assessment of 'needs' in the domestic market." Rosemary Morris, *The Scheduling of Economic Needs Tests in the GATS: An Overview*, in TRADE IN SERVICES: NEGOTIATING ISSUES AND APPROACHES 27, 28 (OECD 2001).

<sup>130</sup> See Morris, *supra* note 129, at 28.

The three-year waiting period imposes a delay on the opening of multiple offices that could affect all foreign firms, but disproportionately hurts those firms that have not yet met the three-year requirement or have not yet established a presence in China. The three-year waiting period could also impose a delay on firms that have maintained a long-term presence in China and that wish to open more than just two offices, because the three-year clock may restart as of the establishment of the last representative office.<sup>131</sup> The three-year waiting period is, in theory, supposed to be used by the MOJ to evaluate the performance of a firm before permitting it to open a second office<sup>132</sup> but, depending on how it is applied, it could also serve as a quantitative restriction on the establishment of resident representative offices.

Neither the “genuine need” requirement nor the three-year waiting period can be squared with China’s explicit commitment that “geographic and quantitative limitations will be eliminated within one year after China’s accession to the WTO.”<sup>133</sup> In a report to the United States Congress on China’s compliance with its WTO commitments, the Office of the United States Trade Representative (“USTR”) has acknowledged that “procedures for establishing a new office or an additional office are unnecessarily long and call into question China’s commitment to eliminate all quantitative limitations on new offices by December 11, 2002.”<sup>134</sup> That said, China’s compliance with its GATS commitments on legal services will ultimately depend on how strictly the MOJ enforces the Regulation, and judgment should be reserved until a fuller record is available for review.

*B. The Regulations May Harm Chinese Law Firms and Retard the Development of the Legal Services Sector in China*

In addition to concerns that the Regulations and Implementing Rules may violate the terms of China’s accession to the WTO, a more practical concern is the impact they may have on the development of the legal services sector in China. Because the Regulations and Implementing Rules put a protectionist spin on China’s Specific Commitments under the GATS, they initially represent a tilting of the playing field in favor of domestic law firms. However, in the long run, they are likely to hinder the growth of the

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<sup>131</sup> See Implementing Rules on Foreign Law Firms, *supra* note 104, art. 10.

<sup>132</sup> See Xiao, *supra* note 11.

<sup>133</sup> Schedule of Specific Commitments, *supra* note 65, at 5.

<sup>134</sup> USTR, 2002 REPORT TO CONGRESS, *supra* note 9, at 44. See also Murphy, *supra* note 8, quoting Professor Donald Clarke: “This is certainly against the spirit of China’s WTO commitments. In the WTO agreement China didn’t say: ‘You can set up a representative office only if we think it’s needed.’”

legal services sector in China because they go too far in protecting domestic firms.

### 1. *The Regulations Favor the Largest Foreign Firms*

At the outset, it must be said that to the extent the Regulations merely formalize restrictions that were only loosely enforced in the past,<sup>135</sup> they do not necessarily add to existing barriers to entry. For example, the regulations that prohibit foreign law firms from circumventing registration procedures by establishing new offices as consultancies or prohibit the formation of joint ventures, which many observers believed would be permitted under the Regulations' "entrustment" provisions, pre-dated the Regulations.<sup>136</sup>

However, depending on how they are enforced, the Regulations and Implementing Rules may have carried over quantitative restrictions on new offices in the guise of a three-year waiting period and several highly ambiguous qualitative restrictions. These new and less predictable restrictions could favor some firms over others. For example, in addition to the economic needs test, one of the other factors the MOJ will consider under its new rules is the applicant's size.<sup>137</sup> Although the rules do not explicitly state that large firms will be favored, a survey of the firms that have been approved for second offices under the new rules suggests that is precisely how the MOJ has interpreted the rules.<sup>138</sup> Another example of a new restriction is the six-month residency requirement for all representative attorneys.<sup>139</sup> These and other new restrictions impose substantially higher costs on foreign law firms.<sup>140</sup>

<sup>135</sup> See Davis, *supra* note 58, at A6.

<sup>136</sup> See discussion *supra* Part II.C.

<sup>137</sup> Implementing Rules on Foreign Law Firms, *supra* note 104, art. 4.

<sup>138</sup> On June 10, 2002, Allen & Overy, Clifford Chance and Linklaters—three of the four largest U.K. firms—became the first non-Hong Kong foreign firms to win approval to open second offices in China. *China Ends Office Restrictions for Foreign Firms*, INT'L FIN. L. REV. (July 2002). In December 2002, U.K. firms Herbert Smith and Masons and U.S.-based Baker & McKenzie; O'Melveny & Myers; Vinson & Elkins; and Jones, Day, Reavis & Pogue were granted licenses to open second offices. *O'Melveny & Myers LLP Opens New Office in Beijing*, ASIA PULSE, Dec. 19, 2002, LEXIS, News Group File; *Foreign Lawyers Proliferate*, FAR E. ECON. REV., Jan. 9, 2003, at 22; *Hong Kong Proves a Graveyard for Camerons and Dewey Ballantine*, LAWYER, Jan. 27, 2003, at 2. With the exception of Masons, all of the firms granted licenses to operate second offices are among the top fifty highest grossing firms in the world. *The Global 100*, AM. LAW., Nov. 4, 2002, LEXIS, News Group File.

<sup>139</sup> Although this is a new restriction, it was a limitation listed on the GATS schedule. See discussion *supra* Part III.B.2.

<sup>140</sup> The six-month residency requirement means that firms can no longer fly in a representative or cycle through a "team" of alternate representative attorneys and must instead invest significant human resources, particularly in the case of a chief representative, into the establishment and maintenance of an office. See Sommers, *supra* note 11. According to a former MOJ official, the Chinese authorities



From an economic perspective, these costs are represented as higher barriers to entry, both for foreign firms interested in entering the China market and for foreign firms that have not yet met the three-year establishment requirement. These restrictions and the uncertainty created by ambiguous new provisions are therefore likely to favor the largest foreign firms who already maintain a presence in China because, by virtue of their size, these firms are better able to take advantage of economies of scale in defraying these new costs.

2. *The Regulations Are Overly Protective and Fail to Provide Adequate Opportunities for Chinese Lawyers to Train with Foreign Lawyers*

For Chinese law firms, the Regulations and Implementing Rules undeniably offer some short-term protection, the duration of which will depend on how the MOJ enforces the Regulations. For example, under the Implementing Rules, foreign firms are prohibited from hiring away practicing Chinese lawyers from Chinese firms.<sup>141</sup> The Rules also carve out areas where only Chinese firms may provide services, such as those involving litigation or lobbying of government entities, and because the new rules bar the formation of joint ventures or partnerships with foreign firms, foreign firms must refer such matters to be handled by an outside Chinese law firm. While these protections may initially sound appealing to Chinese lawyer, there is a very real question as to how meaningful these protections will be to Chinese firms in the long run.

Indeed, the Regulations may be too effective in protecting Chinese firms from direct competition in matters dealing with “Chinese legal affairs,” potentially lulling these firms into a false sense of security and discouraging them from competing against foreign law firms in areas outside the scope of “Chinese legal affairs.”<sup>142</sup> A protected niche might not seem like a negative outcome for Chinese firms, but the reality of China’s legal services market is that it is increasingly dominated by multinational and large Chinese corporate consumers of legal services.<sup>143</sup> “Law firms face a

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recognized “[m]ost foreign lawyers who are willing to go to such a developing country as China are young practitioners who just receive [sic] their licenses. A lawyer with more than three years of practice experience is more reluctant to go to China out of concerns over quality of life and living expenses. Hence, this requirement can effectively limit the number of lawyers who may join the China practice.” Xiao, *supra* note 11.

<sup>141</sup> See discussion *supra* Part IV.B.

<sup>142</sup> *Id.*

<sup>143</sup> PEERENBOOM, *LAWYERS IN CHINA*, *supra* note 23, at 25. Three-hundred-fifty billion dollars in foreign investment in the last decade has driven the growth of China’s economy. Keith Bradsher, *Another*

huge demand to provide multijurisdictional and multidisciplinary advice with a strong element of local knowledge . . . [and] are expected to offer fully integrated services on all parts of a transaction."<sup>144</sup>

At the moment, Chinese law firms are ill-equipped to service these multinational clients for a number of reasons, some historical, others structural.<sup>145</sup> Limitations on Chinese law firm participation in cross-border and other complex transactions include the shortage of lawyers<sup>146</sup> and quality control problems that have yet to be resolved.<sup>147</sup> Unfortunately, the Regulations and Implementing Rules only exacerbate the problem by limiting the interaction of Chinese lawyers with their foreign counterparts.<sup>148</sup> Without exposure to cross-border transactions, Chinese lawyers may not be able to develop the expertise necessary to compete with foreign firms for this large, and growing, segment of the market.

A structural weakness of the Chinese legal services sector is its fragmented organization.<sup>149</sup> It is almost entirely populated by a large number of small or medium-sized firms averaging fewer than ten attorneys and engaging in litigation practice.<sup>150</sup> Only a few firms in Beijing and Shanghai are large enough to deal in the more profitable areas such as legal consultancy.<sup>151</sup> As one Chinese lawyer explains, "lawyers in the smaller firms either do not have the expertise to handle the complex trans[actional] commercial matters, or do not have the foreign language skills to communicate with the foreign clients effectively."<sup>152</sup> More importantly, the fragmented structure of the domestic legal services sector suggests an

*Asian Nation Battling a Crisis in Its Banking System*, N.Y. TIMES, Oct. 26, 2002, at C1; available at LEXIS, News Group File.

<sup>144</sup> Frances Gibb, *U.K. Firms Could Provide Valuable Training*, TIMES OF LONDON, Oct. 22, 2002, 2002 WL 100456748.

<sup>145</sup> See Xiao, *supra* note 11.

<sup>146</sup> See discussion *supra* Part II.B.

<sup>147</sup> *Id.*

<sup>148</sup> *Id.* See also Sommers, *supra* note 11, at 6 (noting that the residency requirement in new regulations effectively prevents foreign law firms from hiring Chinese LL.M. candidates studying overseas).

<sup>149</sup> A fragmented industry is characterized by the absence of market leaders with the power to shape the direction of the industry. MICHAEL E. PORTER, *COMPETITIVE STRATEGY: TECHNIQUES FOR ANALYZING INDUSTRIES AND COMPETITORS* 191 (1980) [hereinafter PORTER, *COMPETITIVE STRATEGY*].

<sup>150</sup> *Immature Law Firms Fight for Market Niche After WTO Entry*, CHINA BUS. INFO. NETWORK, Mar. 5, 2002, 2002 WL 7262209. The largest firm in Shanghai, AllBright Law Offices, advertises itself as "a full-service law firm of more than 150 attorneys." <http://www.allbrightlaw.com/welcome/index.htm> (last visited Apr. 30, 2003). The largest law firm in Beijing, Lehman, Lee & Xu, boasts "over 100 experienced lawyers." [http://www.lehmanlaw.com/lehman/Firm/firm/Firm\\_summary.htm](http://www.lehmanlaw.com/lehman/Firm/firm/Firm_summary.htm) (last visited Apr. 30, 2003).

<sup>151</sup> *Immature Law Firms Fight for Market Niche After WTO Entry*, *supra* note 150.

<sup>152</sup> *Id.*

absence of economies of scale or experience,<sup>153</sup> which places Chinese law firms at a competitive disadvantage to larger foreign firms that can leverage economies of scale to reduce costs.<sup>154</sup>

If Chinese law firms do not have an incentive to pursue cross-border transactions now, the competitive gap with foreign firms is certain to widen. If the Regulations and Implementing Rules favor the expansion of the world's largest firms into China, while simultaneously reinforcing the separation of Chinese and foreign firms in their respective market segments, the result may be an even wider "competitive divide" between large foreign firms, capable of taking advantage of economies of scale and scope, and small Chinese firms, lacking the geographic presence and experience necessary to compete.

#### VI. FURTHER LIBERALIZATION IS NECESSARY TO STRENGTHEN CHINA'S LEGAL SERVICES SECTOR AND SUSTAIN HIGH LEVELS OF ECONOMIC GROWTH

Because the protectionist approach reflected in China's new foreign law firm regulations is not likely to improve the competitive position of Chinese law firms in the long run, China should instead further liberalize its legal services market by lowering barriers to entry and encouraging greater interaction between foreign and Chinese lawyers. Competition should not only accelerate the development of Chinese legal services providers, but may also strengthen their competitive position internationally. By improving access to legal services, liberalization can also generate benefits for the entire Chinese economy. In other words, China can support development of efficient, professional Chinese legal services providers without sacrificing economic growth. Indeed, an efficient legal services sector, consisting of both foreign and domestic firms, is necessary to sustain China's high levels of economic growth.

##### *A. Competition Should Accelerate the Development of Domestic Firms and May Strengthen Their Competitive Position*

Chinese firms would benefit from a more liberal regulatory environment. Although few studies have directly examined the impact of

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<sup>153</sup> See PORTER, *COMPETITIVE STRATEGY*, *supra* note 149, at 196.

<sup>154</sup> See Alan V. Deardorff, *International Provision of Trade Services, Trade and Fragmentation*, 9 *REV. INT'L ECON.* 244, 244-45 (2001).

liberalization of legal services,<sup>155</sup> competition can generally strengthen, rather than weaken, a firm's competitive position.<sup>156</sup> Indeed, competition can yield a number of strategic benefits, including increasing competitive advantage, improving industry structure and aiding market development.<sup>157</sup>

The experiences of other countries with legal services liberalization support this conclusion. For example, greater international competition is thought to have contributed significantly to the strengthening of German and Canadian law firms and to an improvement in their international competitiveness.<sup>158</sup> On the other hand, Japanese law firms, which continue to operate in a heavily regulated and relatively closed domestic legal market, remain small and tend to be less competitive internationally.<sup>159</sup> Finally, Hong Kong, which has long had the most liberal approach to foreign law firms in Asia due to the historic presence of British firms, has a much more sophisticated legal services sector.<sup>160</sup>

#### B. *Competition Can Generate Positive Welfare Effects for the Chinese Economy*

Not only can competition help strengthen Chinese legal services providers, it can also generate benefits for the entire economy. In one econometric study of the impact of competition on pricing and quality of legal services in England and Wales, researchers found that "the threat of competition . . . yielded significant welfare benefits" including a reduction in the cost of such services and a "measurable improvement in consumer satisfaction."<sup>161</sup>

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<sup>155</sup> Thierry Noyelle observes that "available measures of employment and output in professional business services leaves much to be desired, rendering their analysis somewhat difficult." Thierry Noyelle, *Business Services and the Uruguay Round Negotiations on Trade in Services*, in TRADE IN SERVICES: SECTORAL ISSUES, at 312, U.N. Doc. UNCTAD/ITP/26, U.N. Sales No. GE.89-56975 (1989).

<sup>156</sup> See, e.g., MICHAEL E. PORTER, COMPETITIVE ADVANTAGE: CREATING AND SUSTAINING SUPERIOR PERFORMANCE 201 (1985) [hereinafter PORTER, COMPETITIVE ADVANTAGE].

<sup>157</sup> See *id.* at 202-07 (noting that the presence of competitors can increase overall industry demand).

<sup>158</sup> David M. Trubek et al., Symposium, *The Future of the Legal Profession: Global Restructuring and the Law: Studies of the Internationalization of Legal Fields and the Creation of Transnational Arenas*, 44 CASE W. RES. L. REV. 407, 447 (1994); Richard L. Abel, Symposium, *The Future of the Legal Profession: Transnational Law Practice*, 44 CASE W. RES. L. REV. 737, 781-82 (1994).

<sup>159</sup> R. Daniel Kelemen & Eric C. Sibbitt, *The Americanization of Japanese Law*, 23 U. PA. J. INT'L ECON. L. 269, 299-303 (2002).

<sup>160</sup> Darryl D. Chiang, *Foreign Lawyer Provisions in Hong Kong and the Republic of China on Taiwan*, 13 UCLA PAC. BASIN L.J. 306, 310-12, 342-44 (1995).

<sup>161</sup> Simon Domberger & Avrom Sherr, *The Impact of Competition on Pricing and Quality of Legal Services*, in THE REGULATORY CHALLENGE 119, 137 (Matthew Bishop et al. eds., 1995).

Historically, trade negotiations have traditionally focused on trade in goods and reducing and eliminating barriers at the border for those goods.<sup>162</sup> However, once goods are past the border, the efficiency of services defines the ability of goods to penetrate the marketplace.<sup>163</sup> China, which has historically had a particularly anemic services sector, accounting for only thirty-three percent of its gross domestic product,<sup>164</sup> has relatively more to gain from liberalization because liberalization of services sectors will also improve the competitiveness of Chinese goods.<sup>165</sup> Thus, services liberalization has implications for the efficient operation of the economy. This is borne out by studies which have demonstrated that increasing competition in services has a multiplier effect that enhances a country's economic growth beyond the services sector, enhances the country's competitive position globally, and expands market access for goods.<sup>166</sup>

Legal services, like many other services, may be thought of as a part of the infrastructure of a global economy, one that plays a critical role in facilitating the international trade of goods and other services.<sup>167</sup> In the context of China's economy, legal services providers have a vital role to play in China's transition as a new member of the WTO. Consider, for example, that since joining the WTO, China has experienced a surge in Foreign Direct Investment ("FDI"), which, according to the Ministry of Foreign Trade and Economic Cooperation ("MOFTEC"), grew some 12.5% in 2002 to reach record levels of over \$52.7 billion.<sup>168</sup> In 2002, China, for the first time, may have surpassed the United States in becoming the world's

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<sup>162</sup> See ROBERT B. CASSIDY, TRADE IN SERVICES IN CHINA: IMPLEMENTING THE WTO 25 (NBR Special Report No. 3, Nov. 2002).

<sup>163</sup> *Id.*

<sup>164</sup> Compare to Hong Kong, which has one of the largest services sectors in the world that accounts for 89% of GDP, the United States at 72%, Japan at 61%, and South Korea at 52%. WORLD BANK, DEVELOPMENT INDICATORS (2002). China's employment of service workers as a percentage of total employment is a scant 12-13%, while service workers in the United States, United Kingdom, and Hong Kong make up over 70% of their workforces. *Id.* Korea and Japan employ approximately 61% and 63% of their workforces in services, respectively. *Id.*

<sup>165</sup> Noyelle, *supra* note 155, at 37 ("Developing countries stand to gain relatively more than industrial countries from liberalizing their services trade.").

<sup>166</sup> Deardorff, *supra* note 154, at 233. See also Azmat Gani & Michael D. Clemes, *Services and Economic Growth in ASEAN Economies*, ASEAN ECON. BULL., Aug. 2002, at 155 (showing that "expansion of the service sector seems to play a crucial role in the economic development of the ASEAN economies, as services in general bind the other sectors of the economy such as manufacturing.").

<sup>167</sup> See Deardorff, *supra* note 154, at 234. See also Noyelle, *supra* note 155, at 23 ("Business services such as accounting and legal services are particularly important for reducing transaction costs, the high level of which is often a major impediment to economic growth in developing countries.").

<sup>168</sup> *China's FDI Grows 12.51% in 2002*, BUS. DAILY UPDATE, Jan. 15, 2003, available at LEXIS, News Group File; Press Release, Chinese Min. of Foreign Trade and Economic Cooperation [hereinafter MOFTEC]; *Overseas Investment to China Reaches US\$52.7 Billion*, available at [http://english.moftec.gov.cn/article/200301/20030100063506\\_1.xml](http://english.moftec.gov.cn/article/200301/20030100063506_1.xml) (last visited Apr. 30, 2003).

top recipient of FDI.<sup>169</sup> More than 400 of the world's 500 largest companies have launched operations in China.<sup>170</sup> The number of newly-approved foreign-invested ventures grew at an annual rate of 30.72% in 2002 with the contractual volume of foreign investment increasing by almost 20%.<sup>171</sup> Foreign investment inevitably results in trade contracts, licensing agreements and the formation of wholly foreign-owned entities or joint ventures. Thus, if FDI continues to grow, as anticipated,<sup>172</sup> China's legal services infrastructure will similarly have to grow to fulfill the additional demand for legal services.<sup>173</sup>

FDI is not the only driver of demand for legal services in the Chinese economy. Bankruptcy of State Owned Enterprises and resolution of non-performing loans remain two of the most important issues threatening China's economic growth.<sup>174</sup> Resolution of these issues requires "an effective and efficient system of reorganizing insolvent enterprises, and transferring resources out of non-viable uses and into more productive ones."<sup>175</sup> Another source of demand for legal services is the financial services sector, which, since China's entry to the WTO, has experienced one of the highest levels of growth of any sector of the economy.<sup>176</sup> However, the regulations governing foreign lawyers have not permitted foreign law firms to adequately meet the demand for legal services in this sector.

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<sup>169</sup> *Foreign Investment Hits Record*, CHINA DAILY, Jan. 15, 2003.

<sup>170</sup> BBC Monitoring Int'l Rep., *More Than 4 out of 5 of the World's Leading 500 Firms Now in China*, Sept. 8, 2002, available at LEXIS, News Group File.

<sup>171</sup> Press Release, MOFTEC, *supra* note 168.

<sup>172</sup> See *Annual FDI to Hit US\$100B*, CHINA DAILY, Jan. 2, 2003, LEXIS, News Group File. The Development Research Centre under the State Council estimates that FDI will reach \$100 billion in every year of the 11th Five-Year Plan period (2006-2010). *Id.*

<sup>173</sup> See Deardorff, *supra* note 154, at 234, stating:

Many services play a critical facilitating role in the international trade of products other than themselves, including both goods and other services. This is most obviously true of transportation services, which are necessary for all international trade in goods. But it is also true, perhaps to a lesser extent, of other services such as finance, insurance, and communication, as well as some professional services that are often needed in order to complete the international exchange of goods.

<sup>174</sup> Private Development Unit, World Bank, *Bankruptcy of State Enterprises in China—A Case and Agenda for Reforming the Insolvency System* (Sept. 20, 2000), at iii.

<sup>175</sup> *Id.*

<sup>176</sup> See Howard H. Jiang & Christian M. Lucky, *Financial Services in China*, REV. BANKING & FIN. SERVICES, Sept. 1, 2003, available at 2002 WL 101825395.

C. *The Regulations Should be Revised to Lower Barriers to Entry and Permit Greater Interaction Between Foreign and Chinese Lawyers*

To encourage the development of an efficient, sophisticated legal services sector, the Chinese government should encourage more competition by revising the Regulations, and, more specifically, their Implementing Rules. Rather than discouraging entry of newcomers to the legal services market, the Regulations should encourage the establishment in China of a more diverse group of small and medium-sized foreign law firms. To that end, the MOJ should strive to improve the transparency of the regulations and reduce particularly costly barriers to entry by eliminating the “genuine need” requirement and the three-year waiting period.

The MOJ should also encourage more interaction between foreign law firms and Chinese lawyers. One way to loosen existing restrictions in a controlled manner would be to eliminate the two-year practice requirement for resident representative attorneys in the case of Chinese lawyers who are recent graduates of foreign LL.M. programs.

VII. CONCLUSION

Some commentators have suggested that China’s new regulations governing foreign law firms violate the terms of its specific commitments under the GATS. However, while compliance with GATS may be one reason to revise the regulations, a more compelling reason for revising the regulations is that they are not likely to meet the Chinese government’s own goals of “facilitat[ing] China’s foreign trade and business” and help[ing] the development of China’s legal profession.”<sup>177</sup> Although the Chinese government’s desire to protect an infant domestic legal services sector is understandable, a more effective approach to improving the competitiveness of China’s domestic legal services providers would be to liberalize access to the legal services market. Liberalization and the competition it brings would invigorate the development of Chinese legal services providers, lower transaction costs and improve the efficiency of the Chinese economy.

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<sup>177</sup> See Xiao, *supra* note 11.