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The Dangers of Electronic Discovery: Lessons From *Morgan Stanley*

By John R. Bielema, Jr. and Michael P. Carey

As has been widely publicized, on May 16 a Florida state court jury awarded $604.3 million in compensatory damages and later an additional $850 million in punitive damages to Coleman Holdings, Inc., the camping gear maker formerly owned by billionaire investor Ronald Perelman, in Coleman's fraud suit against powerhouse investment banker Morgan Stanley & Co. The verdict was notable not only because of its size, but also because of how it came about.

Shortly before the trial, after nearly 2 years of litigation, Judge Elizabeth Maass issued a partial default judgment against Morgan Stanley for what she characterized as a repeated failure to produce e-mails requested by Perelman during discovery. Judge Maass indicated that she would affirmatively instruct the jury to assume that Morgan Stanley had participated in a fraud. At the beginning of the trial, Judge Maass did exactly that; telling the jury that it was to assume that "Morgan Stanley participated in a scheme to mislead (Coleman) and others and to cover up massive fraud." Though Perelman still needed to prove that he relied on Morgan Stanley, the judge's extraordinary instruction rendered an adverse verdict against Morgan Stanley a *fait accompli*.

The *Morgan Stanley* case is the most recent example of the perils that corporate defendants face in the era of electronic discovery. Electronic evidence, and especially e-mail, now plays a starring role in litigation and investigations involving large corporations, particularly in areas such as employment discrimination, fraud and corporate mismanagement. Judges are increasingly familiar with electronic discovery, and are increasingly willing to impose heavy sanctions on corporations who do not comply with electronic discovery requests. As the *Morgan Stanley* case shows, the consequences of these sanctions can be dire. Therefore, it is important that companies take heed of the lessons of the *Morgan Stanley* case, and ensure that they have in place a comprehensive and effective system to recover and produce electronically stored documents.

continued on page 2

Employee Background Checks: The Dos and Don'ts

By Carrie B. Rosen

Whether your company is in the Fortune 500 or a small independent business, hiring and retaining qualified honest employees is critical to your success. In fact, a recent study showed that almost half of all job applicants submitted inaccurate or incorrect information to their potential employees. *See,* ADP 2004 Hiring Index, available at http://adphire.com/hiringindex.htm. Given these alarming statistics, it is vital that you conduct background checks even before making hiring decisions.

Why Should You Run Employee Background Checks?

The Law May Require Them

First, and perhaps most importantly, certain employers are

continued on page 7

Editor's Note

Beginning with this issue, *The Corporate Counselor* expands to 12 pages in order to provide more in-depth coverage and analysis of the issues facing today's GCs. The extra space will allow us to provide our readers with more information to help them in their practice, and allows for the return of the popular Hotline feature to help keep practitioners abreast of key developments.

In This Issue

Lessons from *Morgan Stanley* . . .1

Employee Background Checks: The Dos and Don'ts 1

Contingency Fees: A New Option for Complex Business Litigation . .3

Workplace Wellness Meets Employment Law 5

Time To Check Your D&O Coverage 9

Contingency Fees: A New Option For Complex Business Litigation

By Jeffrey B. Valle and Ben D. Whitwell

For many years, there have been qualified attorneys performing contingent fee services in securities class actions, consumer class actions, toxic tort and personal injury cases. But, historically at least, the contingent fee approach has not been a viable option for complex business cases. Why has this been the case? There seem to be three key reasons: Supply, demand, and tradition.

On the supply side, highly skilled business litigators, with elite credentials, have historically gravitated to the established corporate law firms. These firms are conservative and traditional by nature and will rarely take a case on a contingent fee basis. Indeed, contingent fee arrangements are often viewed by business litigators, and corporate law firms, as not only risky, but even unseemly. This has resulted in a perception of a "bright line" separation between hourly attorneys and firms, on one side of the line, and the plaintiffs' contingency bar, the notorious plaintiffs' trial lawyers, on the other.

On the demand side, businesses have historically been most comfortable retaining counsel from traditional corporate law firms and paying for representation on an hourly basis. This stems in part from the (inaccurate) view that the best lawyers and best law firms work on an hourly rather than contingent fee basis. Moreover, the same perception that there is a "bright line" division between hourly attorneys and the plaintiffs' contingency bar has steered companies away from even thinking about retaining attorneys on a contingent fee basis.

Break With Tradition

As the saying goes, traditions die hard. And there is a long tradition of companies retaining business litigators on an hourly, not a contingent fee, basis. We are well aware of these attitudes and realities because we both worked for many years at large corporate law firms. But we also realize that these traditional fee arrangements have created a very significant market failure — to the detriment of both businesses and business litigators.

Here is a typical example of the dilemma. Suppose a company identifies a potential lawsuit that, if successful, could result in a recovery to the company of between $2 million and $10 million. But the case is complex, it will require substantial legal time and effort, and the result is, at best, uncertain. The company's corporate counsel is thus faced with a very difficult decision. Should the company invest $500,000 to $1 million or more in legal fees to pursue such a case?

When a company is a defendant it only has two choices: Pay the plaintiff or pay for legal representation. Since a defendant is not in the lawsuit by choice, the costs of defense, while unfortunate, are unavoidable. In deciding whether to initiate a lawsuit, however, the calculus is very different. The company might well spend hundreds of thousands of dollars or more litigating this lawsuit of choice, and then lose the entire case on summary judgment or at trial (or recover less than the costs of prosecuting the case). The prudent general counsel knows that if this happens, someone is going to demand to know who decided to file the case in the first place. As a result, companies often talk themselves out of filing potentially meritorious cases because of the substantial upfront investment in legal fees.

The Perfect Solution?

In our view, the business contingency approach offers the perfect solution to this kind of dilemma. If the company can find a firm of qualified business litigators willing to take such a case on a contingent fee basis, the company can greatly reduce the downside risk in filing the lawsuit, while still preserving the upside potential of a large recovery or settlement. From the attorneys' perspective, the representation can provide an opportunity to share in the upside potential of the case, in exchange for assuming a large portion of the downside risk.

But in order for this option to be viable, the three issues we mentioned at the outset — demand, supply and tradition — must be addressed.

Let's start with demand. As the cost of hourly legal services continues to increase, we believe the demand for the contingency option is becoming more and more compelling. Corporate general counsel are under increasing budgetary pressure to keep legal costs down. The strength of the contingent fee option is that it permits a company to pursue litigation without incurring large monthly legal bills. Moreover, when the legal bill does arrive it is, by definition, payable directly from the recovery in the case. Because the economic logic of the contingency option is so compelling, it will in many cases override traditional resistance — but only if there is an adequate supply of skilled business litigators willing to take the cases.

The supply side of the equation has been an historical bottleneck for the reasons noted above. But this is beginning to change. A limited, but growing, list of highly qualified boutique business litigation firms have begun offering clients a contingent fee option in business cases. The experience of these firms has confirmed that the contingency option is an ideal approach in a business case with $2 million to $10 million at stake. The potential recovery in such a case, assuming the merits are sufficiently strong, has justified the investment in attorney time and resources.

continued on page 4

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Contingency Fees

continued from page 3

The ability to avoid substantial upfront legal fees has justified the client's willingness to pay a potentially larger legal fee if the matter is resolved successfully.

Don't Be Afraid To Dive In

We encourage the innovative, open-minded corporate counsel to consider the contingent fee option. At the same time, we offer the following thoughts and advice to keep in mind before entering this largely uncharted territory.

First, companies should not compromise their standards just because the fee structure is contingency rather than hourly. The company General Counsel should ask the question: "Would I hire this attorney or firm if had to pay by the hour?" Even if the company is not paying upfront hourly legal fees, it will still be investing substantial management and employee time and "psychic energy" into the litigation. If your contingent attorneys lack the skill, sophistication and ethics that you are accustomed to, you will surely find the representation disappointing, frustrating, and probably unsuccessful as well. The goal in the business contingency case should not be to simply take a "flyer" with a second rate legal team. Such a bet would end badly most of the time. Rather, the goal should be to find highly qualified legal counsel — *ie*, lawyers you would retain on an hourly basis — who see the potential value in your case and are both willing and capable of litigating the case properly and aggressively to maximize its value. There is a growing number of qualified firms willing to take on such matters, so there is no need to compromise quality simply because the fee structure is innovative.

Second, you should be prepared to engage in a brutally honest, rigorous and thorough pre-retention assessment of your case with potential contingency counsel. Qualified business attorneys presented with a potential contingency case are going to take a long, hard, critical look at the merits of the case and the size of the potential recovery before agreeing to handle the case on a contingency basis. This can be difficult and stressful. Business litigation, like any litigation, can be very emotional. Plaintiffs, even business plaintiffs, often come to a lawyer with a very one-sided view of their case colored by anger and the desire to exact retribution from the other side. While the hourly lawyer (who gets paid win or lose) may be willing to learn the details of the case as the representation progresses, the contingent fee lawyer needs to make a reliable assessment and valuation before beginning the representation. Since contingent attorneys are deciding whether to commit their firms' time and resources to a case with zero return if they are unsuccessful, they do not want to discover a serious factual or legal problem after they have committed to the case.

The client, however, can learn from this intensive pre-retention assessment. The contingent lawyer is likely to be much more candid with the client about the strengths and weaknesses of the case than an hourly attorney who is paid regardless of the outcomes and will usually be happy to take on a new matter regardless of its merits. If the client knows that a firm regularly handles business contingency cases but is rejecting the client's proposed case, the client should consider whether the company actually wants to make the legal fees "investment" after the contingency attorneys declined the opportunity. On the other hand, when an experienced attorney agrees to take your case on a contingent fee basis, you have received a meaningful vote of confidence in the merits and value of your case. Moreover, by conducting a serious and thorough analysis of the case at the beginning, both the lawyer and the client will be much better prepared to deploy a successful litigation strategy from the outset. The case assessment process should include, at a minimum, an attempt to reach broad agreement about the strengths and weaknesses of the case, the value of the case, the litigation strategy, and settlement attitudes and expectations.

Working Together

It is also important to remember that the dynamics of the attorney-client relationship are quite different in a contingent fee case. Lawyer and client are, in a very real sense, joint venturers. They both have a direct financial interest in every strategic decision in the case. Every strategic decision therefore takes on added importance. This is fine when lawyer and client agree, but can be tricky when they do not. Whether, when and at what level to settle the case is a classic area where such conflicts can arise. Although these issues have played out over the years in other contingency litigation, they can be particularly acute in the business litigation case where the legal and factual issues tend to be more complex.

We have found that these issues are all manageable. But we cannot overemphasize the importance of carefully choosing contingency counsel and conducting a thorough pre-retention case assessment. The contingent fee option is not for everyone and is not appropriate in every case. But, as business litigators who have been successfully implementing a contingent fee approach in complex business cases, we believe we are part of a growing vanguard of lawyers who are beginning to respond to a significant market failure of the traditional hourly fee model in business litigation.

Properly viewed, a company that has been wrongfully injured has acquired a "contingent corporate asset" in the form of a legal claim for compensation. It is up to the company's General Counsel and upper management to maximize potential recovery and at the same time minimize company risk. Historically, company's have had to make the difficult choice between paying substantial upfront legal fees in such cases, or foregoing the lawsuit altogether. But it is worth remembering that there is an alternative. Carefully chosen litigation attorneys willing to "invest" in the case by working on a contingency basis can be the perfect approach to achieve the upside potential while minimizing the downside risk.

*To comment on this month's articles or suggest a story idea, contact Editor-in-Chief **Adam Schlagman** at schlag@rcn.com.*