General Counsel Experiment With Full Contingency Fees

Blended Hourly Rates See A Resurgence

LITIGATION

BY JARRETT BANKS

WHEN CHARLES SNYDER, the owner of Instant Fire Protection, a small fire-safety company based in Los Angeles, decided to sue two companies for breach of contract, he asked his outside lawyers to work on a full contingency fee basis.

"I got screwed by my own attorneys [previously], and it cost me $400,000," Snyder says of a case where his attorneys were paid by a standard hourly rate. Despite the 33 percent cut of the settlement his lawyers took for the breach of contract case in March, Snyder says it was well worth it. "Otherwise I wouldn't have sued at all," he says.

While full contingency fee cases are fairly rare in the corporate world, they do happen. Blended contingency fees have been around for a long time, but more and more they are gaining ground in a cut-throat business environment where legal departments are under increased budgetary constraints. In *CLT*'s most recent legal department budget survey ("The Numbers Game," May 2005, p.38) 59.3 percent of respondents who said they had employed alternative fee arrangements with outside counsel used blended hourly rates—a 7.3 percent jump from 2003, in which 52 percent of respondents reported using blended hourly rates.

By having an outside law firm take a case at a reduced hourly rate plus a percentage of the settlement or judgment, corporations can align their economic interests with the law firm and share the risk.

Blended Option

In June 2003 Seth Weisberg, the general counsel of Stamps.com, did exactly that. The Los Angeles-based Internet postage provider sued Web-giants eBay and PayPal for tortious interference and breach of contract, respectively. Citing constant pressure to control litigation costs, Weisberg went to outside counsel for an early assessment of his case.

Rather than using a full contingency fee arrangement—e.g., the law firm gets 33 percent if the case is settled before trial, 40 percent if it goes to trial, and 45 percent if it goes all the way to appeal—Weisberg and his outside counsel agreed to a reduced hourly rate and 20 percent of the settlement or award.

"From a cost controlling point of view, if you have a case that has enough value that you can engage contingency counsel, it allows you to save in the legal fees along the way," Weisberg says. He used blended rates in a couple matters in the past and found them constructive. "Having an alternative relationship with a law firm that allows counsel to control and also predict costs better is very desirable."

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—Seth Weisberg
General Counsel
Stamps.com

Jeffrey Valle, founder of Valle & Associates, a small law firm in California, which represented Stamps.com, believes the real incentive for corporations to use blended or full contingency fees is to be able to pursue valid claims without burdening the balance sheet with legal expenses.

In the Stamps.com case, which settled earlier this year, there was a frank discussion between Weisberg, Valle and Ben Whitwell, a partner at Whitwell Jacoby Emhoff, who teamed up with Valle on the case. Valle and Whitwell made an upfront assessment on whether to take a case on a blended contingency basis. In their assessment, they looked at three areas: the likelihood of success, amount of damages and relationship with the client.

Contingency fees were once reserved for personal injury lawyers. But these types of arrangements are becoming more popular in the corporate world as firms seek to attract business, and corporations seek to save money and share risk.

Determining the likelihood of success can be tricky. "No matter how much work you do up front, you're probably not able to do all the legal research you need to do," Valle says. He's a big fan of the morality plays involved in cases. "I'd love to have some smoking guns if possible, but those may require discovery. I'm not enormously worried about particular legal barriers unless there's a killer statute of limitations problem."

No matter how good a case is, if the damages aren't high enough, it won't make economic sense for a law firm to agree to a blended contingency fee. "It starts to get a little more marginal if it's under [$2 million] because I'm going to have a team of experienced litigators litigate the heck out of this thing," Valle says. Also, a good relationship with the client is paramount. "I know that we're going to be involved in something that has a teamwork element that is different from the hourly relationship, because every strategic decision effects both of our pocketbooks."

Although Stamps.com used a small firm to litigate its case, most law firms, whether large or small, most likely will entertain a blended fee arrangement. "I don't think the size of the firm has anything to do with it," says Thomas Birsic, partner at Kirkpatrick & Lockhart Nicholson Graham.

The size of the company also doesn't seem to have an impact on whether blended fee arrangements are used.

"You may have a big company with lots of resources that wants to share the risk," says Robert Haig, a partner at Kelley Drye & Warren in New York, who has written extensively on business litigation. "The reason [the company] wants to share the risk is it sees the contingency fee as a motivating factor for the lawyers to do their best and most efficient work."

Limits Of Success

Critics of pure contingency fee arrangements, however, argue that it's too much of a zero-sum game.

"A pure contingency fee arrangement completely externalizes the risk to the law firm and it externalizes control of the matter to the law firm," Birsic says. "It disconnects the corporation from the litigation in a way that most corporations find to be

Simplifying The Relationship

While the era of traditional hourly fees won't be ending any time soon, many general counsel complain that they don't have the time to read endless time sheets that law firms submit for hours of service rendered.

Jeffrey A. Kaplan, assistant general counsel for the Chevron Phillips Chemical Co., has been in-house for four years and is appalled by the monthly bills his law firms submit.

"I'd almost rather have a one-page narrative from everyone—it's gotten to the point where I read bills that are 30 or 40 pages," he says.

Similarly, Jeffrey W. Carr, general counsel of FMC Technologies, uses alternative fee arrangements for all of his company's matters. "We use a risk-reward system. We virtually never work with outside counsel that don't do this," he says. In 2004, *CLT* profiled FMC Technologies and its use of the Alliance Counsel Engagement System (ACES), a billing model Carr's legal department devised to alleviate growing frustration between in-house lawyers and outside counsel.

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—Jeffrey W. Carr
General Counsel
FMC Technologies

"We realized firms were not given incentives to be efficient," Carr said in 2004. The purpose of the system was to align the company's interests in rapid, successful and cost-effective delivery of legal services with a fair compensation model for the outside firm. The major component of the billing model is an upfront assessment between in-house and outside counsel, an agreement on a success strategy and the implementation of an appropriate budget from which the law firm can work.

Jeffrey W. Carr

—*Jarrett Banks*

unappealing for a matter that is of some significance to them."

He believes that the most successful alternative fee structure is a fixed fee for a specific scope of work with success fee components built into the arrangement. Fixed fees often eliminate staffing disputes between in-house and outside lawyers because they shift the responsibility of managing the engagement from the legal department to the law firm.

Birsic cites the example of DuPont, which is creative and proactive in using fixed fees. "DuPont is one of the pioneers of the use of alternative fee arrangements in corporate America and has made it a core principle in its legal model for more than 10 years," he says.

Another big disadvantage of contingency fees is that most law firms would rather not take on the risk. "It's kind of like the difference between being a miner and someone who's been hired to dig the shaft," Whitwell says. "You get paid whether you find gold at the bottom or not. In our case we don't get paid to dig the shaft, but we get paid a lot if we find gold."

Whitwell believes that blended contingency and full contingency arrangements only make sense for corporations in the right situation. "If there's a huge amount of controversy, you don't want to wind up paying the lawyers $20 million. There can be cases that can be too big and too small."

The downside from the company's perspective is that top law firms won't work on contingency, so you run the risk of putting a winnable case in jeopardy by using a less qualified lawyer.

Stigma Gone

One of the reasons contingency arrangements are perceived as somewhat unseemly by corporations is because of personal injury lawyers who run incessant ads on TV in search of clients.

"They don't want to invest the time to do the case because they're not getting paid. They're just trying to flip them to get a return," Valle says.

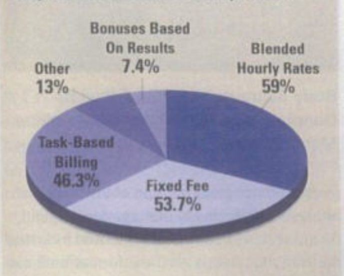
He believes that the stigma of contingency fees doesn't apply in his dealings with corporations because he has specific experience in business litigation. "Contingency fees really make sense for lawyers and they're great for clients—as long as they can find lawyers who have the skill and experience."

From the corporation's perspective, giving law firms an incentive will encourage effort and ingenuity on the case. While hourly rates won't be going away, full and blended contingency fees are seeing a boost in popularity and provide a useful tool for in-house counsel to align their economic interests with law firms. Once seen as a pariah of the legal world, contingency fees have gained respectability in the corporate world, albeit in moderation.

"I think the stigma has been lifted, if it ever existed," Haig says. ◂

Blended Hourly Rate: A Popular Alternative

Of the respondents to *CLT*'s budget survey ("The Number Game," May 2005, p. 38) who said they employ alternative fee arrangements, more than half said they had used blended hourly rates.



Note: Respondents could select more than one answer.

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Founder
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