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Transforming a Legal Department From Cost Center to Revenue Source

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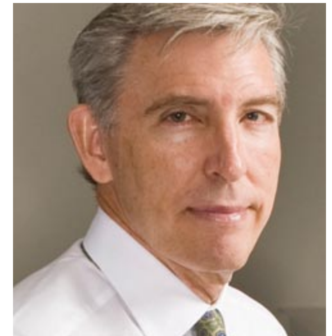
Innovative legal departments, by aggressive pursuit of "recoveries," have transformed what was once viewed as a cost center into a revenue source for their companies.

The current economic environment will cause executives, particularly those in the hard-hit financial sectors, to explore ways to cut legal expense. Equal attention, however, should be focused on maximizing returns from recovery efforts and dampening the financial risk of those undertakings.

The rising trend on the part of corporate America to pursue recoveries was first noted in the 3rd Annual Fulbright & Jaworski Litigation Trends Survey Findings (2006). One of the findings presented was, "While businesses may sometimes feel under a siege of defensive litigation, the battle is definitely two-sided: over 70 percent of respondents initiated at least one lawsuit in 2005-2006, with nearly half filing up to five fresh actions."



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By 2008, companies were reporting the financial success of their recovery initiatives. Citing as one example DuPont's pursuit of matters where supplier pricing triggered antitrust concerns, Thomas L. Sager, VP and assistant counsel at DuPont Legal, reported that launching plaintiff lawsuits had brought in over $500 million during the first three years of the program. As co-author of "Plaintiff Thinking Can Grow Your Bottom Line", appearing in ACC Docket January/February 2008, he endorsed the advantages of adopting strategies from the plaintiff's playbook.

A contrasting anecdote from a *Fortune* 500 chemical company general counsel is a reminder that prudent recovery efforts require careful risk calibration and are best done by

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requiring maximum clarity and transparency from their legal service providers. In that case, spending well into the seven figures on hourly rate-based legal fees in an attempt to recover damages in a patent infringement matter ultimately netted a zero recovery. Unacceptable results can quickly dampen enthusiasm for aggressive pursuit of plaintiff actions, whether in the intellectual property, business tort or breach of contract realms.

Corporate boards however, perhaps mindful of the publicity given to extravagant legal fee awards to plaintiffs counsel, are understandably reluctant to potentially "give away" money to lawyers by engaging law firms to pursue recovery matters on a contingency basis. Close examination of one segment of the financial services industry justifies that reluctance.

Although insurers pioneered in many ways the concept of converting a cost center into a profit center by pursuit of recoveries on paid claims, reliance on a contingent fee engagement model has resulted in many six- and seven-figure value cases, in the payment of legal fees that are multiples of those that would otherwise be earned at regular hourly rates. Continued reliance on that model is puzzling because contingent fees are typically justified on the basis of risk, whereas in the case of companies that generate a stream of plaintiff assignments, risk would regress to close to zero at particular case volume levels.

The ideal model would provide for a rational assessment of risk/reward prospects including full transparency of precisely how the law firm views the case risk, sensibly constrain costs and excessive contingency premiums, and sharply align interests of client and counsel.

Pure hourly rate engagements can create a wide gulf in alignment since prolonged litigation benefits the law firm, whereas each additional dollar spent in fees is no guarantee to the client of an equivalent boost or more in recovery. On the other hand, closer scrutiny of the pure contingency model reveals imperfect alignment, potential hidden conflicts and ethical issues simmering behind the facade of purported aligned interest celebrated by proponents of that model.

Prosecution of plaintiff cases often reach the point where continuing a push through the start of trial may create significantly more dollars for the client, but require the investment of firm attorney time value disproportionate to the marginal additional fee such firms will receive under the contingency agreement. In hotly disputed liability cases, recommendation of expenditure of additional cost dollars on items such as experts and discovery may create sufficient settlement leverage to greatly increase the firms probability of receiving a fee to cover expended hours, but costs and fees can rise to a level where little net recovery for its investment is left for the client after payment of those expenses.

Beyond the potential for conflicting financial interests, a spate of recent court decisions and law review articles accentuates the sensitivity clients should have to payment of what may be an excessive contingency fee. Model Rule of Professional Conduct 1.5 prohibits collecting an unreasonable fee, but the not unheard of practice of making contingency assignments to outside counsel before the full range of pertinent facts are studied and alternative fees explored, can reward a firm far in excess of the value of its contribution.

Combining appropriate elements of hourly and contingency structures offers the best solution

to create fuller risk transparency and constrain expense proportional to expected recovery. For example, firms required by their clients to steeply discount their hourly rate on the front end with the promise on the back end of a success fee are fully incentivized to try to meet the recovery and budget goals set forth in the initial litigation management plan. Moreover, there is a clear disincentive to prolong litigation or paint recovery prospects at the outset with too rosy a brush.

Acquisition of sufficient facts during early case assessment in combination with historical data or past experience may permit engagements on a 'capped hourly basis' subject to some adjustments and a similar success fee. A quick case resolution would trigger a 'claw back' to avoid a windfall to the law firm by requiring acceptance of a fee closer in line with the attorney time value expended. Attorney time that exceeded the cap by a fixed percentage might be paid at a greatly reduced hourly rate to address unforeseen contingencies incurred after the initial LMP was accepted.

The above arrangements promote a more optimal alignment of interest and require the law firm to have a purer focus at the outset on the most probable final net recovery to client after legal fees and costs.

Those select companies who, at the tail end of the law firm convergence process, brought firms on board with plaintiff's experience to round out the skill set of their "defense" counsel roster are well positioned to initiate a dialogue on instituting a recovery program to boost their bottom line. Others may discover an opportunity to start a conversation with their present counsel on use of alternative fees for recovery matters that eventually may influence the handling and compensation arrangements on defense matters.

In short, the creativity and imagination companies count on to successfully introduce and maintain brands that constitute the backbone of their financial structure should infuse their approach on legal matters as well. Transforming a company's legal operations into much more than a cost center is a fitting goal for 2009.

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