

LITIGATION 2005

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The Fix Is In

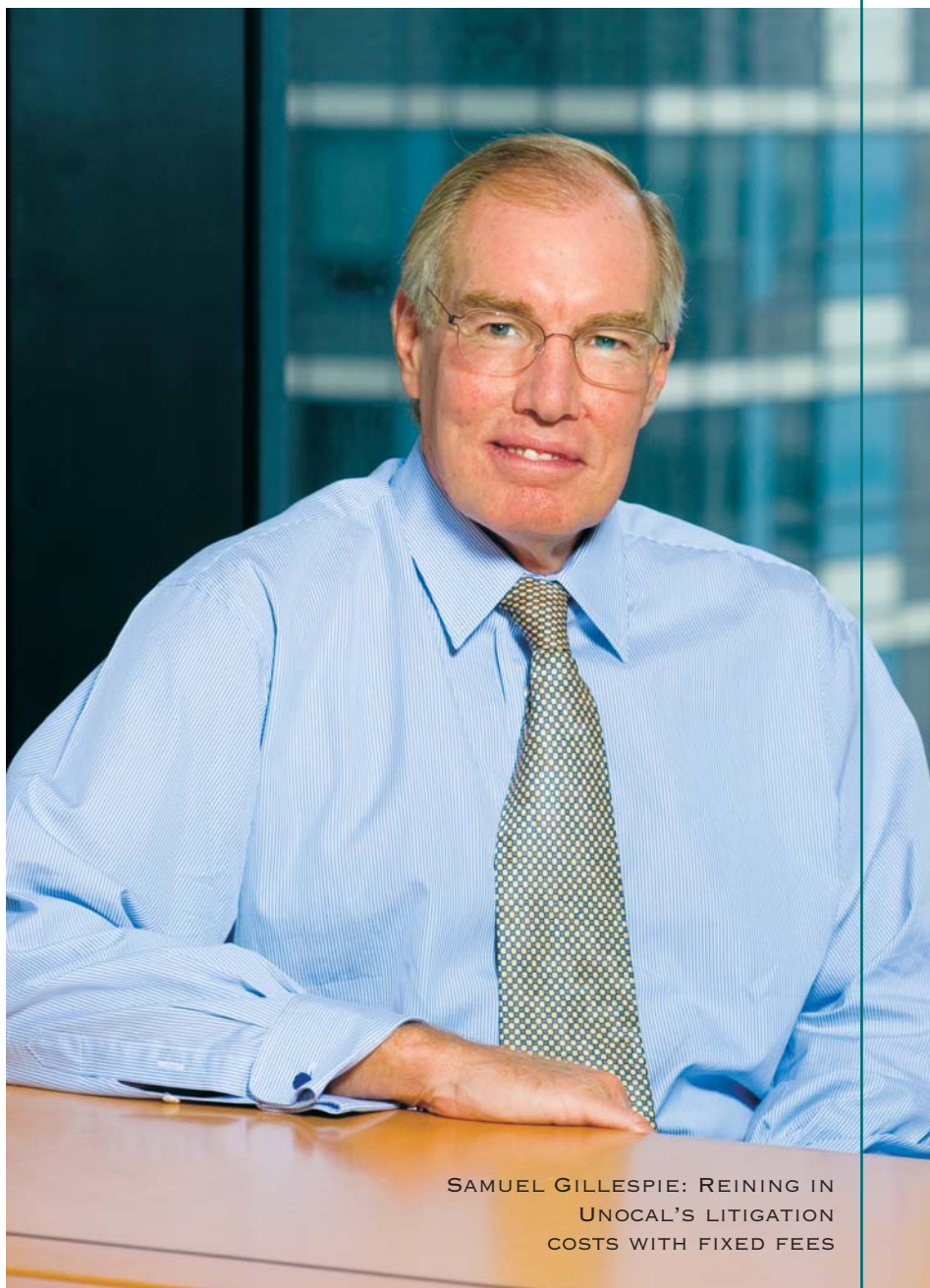
Cisco, Tyco, and Unocal each cut flat-fee deals with outside litigators. The benefits, they say, go far beyond saving money.

BY HEATHER SMITH
PHOTOGRAPHS BY WILLIAM MEBANE

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WHEN SAMUEL GILLESPIE JOINED UNOCAL Corporation as general counsel in October 2003 with a mandate to cut legal costs, he says he could see right away that litigation expenditures were “extraordinarily high.” Environmental litigation stood out in particular. The average case took three years to resolve and cost \$500,000 in legal fees alone. And they usually settled for an average of \$1 million, though some ranged much higher. “A number of [environmental] settlements were in the \$8 million, \$9 million, \$10 million range, and I didn’t even see that when I was at Mobil,” says Gillespie, who had been general counsel at the much larger Mobil Corporation until its 1999 merger with Exxon Corporation.

After Mobil, Gillespie had spent some time on the board of eLawForum, a D.C.-based consulting company that advocates long-term fixed-fee contracts for legal services. Upon examining Unocal’s litigation bills, Gillespie decided to apply what he’d learned about alternative fees at eLawForum to Unocal’s environmental docket to test whether they’d reduce his outside legal costs. After eight rounds of bidding run by eLawForum, Unocal hired Washington, D.C.’s Howrey to handle its entire environmental caseload through 2009 under a fixed-fee contract. “Especially in the oil and gas



SAMUEL GILLESPIE: REINING IN UNOCAL'S LITIGATION COSTS WITH FIXED FEES



HOWREY LITIGATORS ELIZABETH WEAVER AND JOANNE LICHTMAN AND ECONOMIST LAURA ROBINSON: TAKING A CALCULATED RISK ON UNOCAL'S ENVIRONMENTAL DOCKET

business, you have a lot of similarities in [environmental] cases," Gillespie explains. "The same principles tend to apply. With that in mind, it's easier to package them and to feel like you're getting the [legal] expertise you need."

Arrangements like the Howrey-Unocal deal are a rarity today. Although alternative billing enjoyed a brief vogue in the downturn of the early 1990s, a decade later the American Bar Association Commission on Billable Hours reported in 2002 that just a third of the 100-plus-lawyer firms surveyed had recently engaged in any sort of alternative billing—and fewer than a quarter of those arrangements involved litigation.

Why so few? Blame both sides. General counsel worry that they'll commit to paying a fixed fee for cases that might settle immediately or potential litigation that never materializes. Even worse, they

fret, fixed fees might remove any incentive for outside counsel to litigate vigorously. "Howrey is willing to work with alternative fees, and proposes them [to general counsel], but clients rarely go for it," says Elizabeth Weaver, one of Howrey's three Unocal relationship partners. "It takes a big leap of faith." For law firms, the worry is that clients might consider the fixed-fee deal "an all-you-can-eat buffet," in the words of Neal Rubin, director of litigation at Cisco Systems, Inc.: "Will [the firm] just be litigating everything?"

According to some in-house lawyers and outside counsel, however, junking the hourly rate brings rewards that go beyond cost reduction. By removing that mental calculator adding up every call and e-mail, fixed fees mean in-house lawyers bring outside counsel in more often and earlier, increasing the chances for a speedy and cheap resolution. And fixed fees free

outside lawyers from the need to impress clients with their thoroughness: At last, they say, they're rewarded for their legal skills instead of their willingness to invest late nights and weekends.

Not that the cost savings are anything to sneeze at, either. Nine months after Howrey took on Unocal's environmental litigation, average resolution time for cases was down to one year. Unocal litigation chief David Brady reports Howrey is "doing extremely well, bringing in some cases for zero, some for well under \$500,000." Neither Unocal nor Howrey will say how much Howrey is making, but Gillespie estimates Unocal will save \$160 million in legal fees and resolution costs for the 200 matters predicted to arise under the five-year contract.

Unocal and Howrey aren't alone. Last year Shook, Hardy & Bacon took over all of Tyco International Ltd.'s product liability cases for a fixed fee. Morgan, Lewis & Bockius has been handling commercial litigation for Cisco under a fixed-fee contract, also bid out by eLawForum, since 2003. None of the parties involved in the Tyco and Cisco arrangements would give financial details of the contract, but in-house counsel at both companies say they are pleased. These three experiments offer some pointed lessons. Among them:

- **Long acquaintance isn't obligatory.** Shook hadn't worked with Tyco at all before inking its fixed-fee deal. Howrey had no environmental litigation experience with Unocal, though it had done environmental insurance work

as well as other litigation work. And although Morgan, Lewis had worked with Cisco on its commercial litigation before winning that contract, the relationship came with the Brobeck, Phleger & Harrison alumni who joined Morgan, Lewis after Brobeck's collapse.

Instead of extensive work histories, clients and firms got acquainted through long bidding processes. For instance, Tyco held two paper bidding rounds, inviting proposals from 27 firms, including some that had not represented Tyco previously. Seven firms were chosen for in-person interviews with representatives from the legal departments in each of Tyco's five business units, as well as the corporate purchasing group, at Tyco's

preparation—that the litigation firm has assembled to control its own costs and expand the “one-stop shop” idea to litigation support. Laura Robinson, who holds a Ph.D. in economics from Columbia University, calculated the estimated costs in time expended by Howrey lawyers and the bills for regional counsel—which Howrey pays out of its fixed fee—that the firm could expect to face under both the best and worst case scenarios.

The five-year contract will cover about 200 cases—about 80 open files and another 120 future matters—by Unocal's estimates. This ratcheted up the risk for Howrey: Howrey's Weaver says that the firm's previous fixed-fee work had been for “cookie-cutter”

variation year to year, the actual expenses should average close to her calculations, Robinson predicted.

Howrey's bid also included a bonus payment: Firm and client would split any savings if Howrey managed to bring in matters under Unocal's cost target. “If we can do this internally successfully, we can live with this cost quarterly for five years,” managing partner Robert Ruyak recalls thinking. “Over time it averages out, and if we are very successful and achieve their goals, we make a big profit.”

Howrey's business-minded approach appealed to Unocal, convincing Brady and Jill Tracy, head of environmental litigation, to choose Howrey over cheaper alternatives. One of those other firms—Brady won't name it—even offered to pay Unocal for the bragging rights to handle the environmental docket. But the Unocal lawyers felt that the firm didn't seem to appreciate the risks that it would be shouldering. “We chose Howrey because overall they were best able to tell us . . . how they and we would make money,” says Brady.

• **A fixed-fee agreement needs both carrot and stick.** The Howrey-Unocal deal includes a performance bonus that kicks in if the firm succeeds in halving Unocal's average resolution cost to \$500,000, as calculated by 20-case “buck-ets.” Sure, it's an ambitious goal. But Gillespie says that Unocal's high historical costs were mostly due to delay in the initial stages of litigation. With Howrey involved at the first stages, says Tracy, Unocal's lawyers can set a strategy far earlier, sometimes even before a complaint is filed. Howrey's ability to act aggressively from the outset has meant that more claims get dropped altogether; failing that, the company's lawyers can usually reduce settlement costs by



ONE FIRM OFFERED TO PAY UNOCAL FOR THE BRAGGING RIGHTS OF HANDLING THE COMPANY'S ENTIRE ENVIRONMENTAL CASELOAD.

headquarters in Princeton.

The three finalists—two of which had Tyco experience—met again with representatives from the various units to go over their individual concerns and product liability issues, as well as meetings with 25 local and regional counsel that Tyco preferred. Seven months after the initial invitation for bids, Shook, the single newcomer, won.

• **The lowest bid won't necessarily prevail.** Take Howrey's winning bid, which wasn't the lowest (although it wasn't the highest, either). To build its bid for Unocal's environmental caseload, Howrey turned to its in-house economists, one of the four support teams—along with document management, multimedia, and trial

dockets such as asbestos defense. But the large scale of Unocal's contract helped mitigate some of that risk, because it allowed Robinson to devise an estimate that could cover a range of outcomes. Some factors she incorporated were near-certainties: For example, Unocal's service station liabilities would probably decline, since it had sold refineries and the “76” service station chain in 1997. She also considered unknowns, like the likelihood of a global warming-related lawsuit against Unocal or whether Congress would limit MTBE liability payments. From there, Robinson calculated a fixed fee that should cover Howrey's costs. Over the contract, even if there is some

Fixed Terms: Three Flat-Fee Contracts

	CLIENT	PREVIOUS RELATIONSHIP	CONTRACT	LENGTH	SCOPE
HOWREY	Unocal	None on environmental docket; Howrey worked with Unocal on insurance and commercial litigation	Fixed fee paid quarterly; performance bonus based on difference between target resolution cost and actual average of 20-case increments	Five years (October 2004–October 2009)	Environmental (sole source)
SHOOK, HARDY & BACON	Tyco	None	Fixed fee paid monthly; performance bonus determined at six-month intervals, with a percentage of the fixed fee held back until contract ends	18 months (October 2004–April 2006)	Product liability (sole source)
MORGAN, LEWIS & BOCKIUS	Cisco	Some Morgan, Lewis partners worked on Cisco's commercial litigation while they were at Brobeck	Fixed fee paid monthly; no bonus	Two years (August 2003–August 2005; renewed in 2005)	Commercial (not sole source)

making an offer before discovery gets under way, when Unocal has a knowledge advantage and neither side's position has hardened. As a result, settlement payments are about 50 percent lower than they were previously. At press time a bonus had been paid for one group of 20 cases and another awaited final approval of the settlements involved.

The Shook-Tyco agreement provides six opportunities for Shook to earn more than their monthly fixed fee over the contract's 18 months. These include three performance bonuses, based on defined criteria like case resolution and cycle time, and three "holdbacks," or money that Tyco holds onto from the initial estimate of Shook's total costs of the contract, including payments to local and regional counsel. Shook can earn that money back based on more subjective criteria like responsiveness. To date, Tyco has awarded Shook both a holdback and a bonus payment, though neither would say how much they were for.

Tyco's contract with Shook also includes additional, HMO-like incentives

to encourage the firms to use vendors—such as court reporters and contract lawyers—with which Tyco has negotiated lower prices. If Shook uses these vendors, Tyco pays. If Shook goes outside Tyco's network, Shook foots the bill.

Cisco's contract offers no performance-based rewards for Morgan, Lewis, but litigation chief Rubin says Cisco would reward Morgan, Lewis for exceeding Cisco's expectations. Here, it helps that Morgan, Lewis has a good understanding of Cisco through people like partner Franklin "Brock" Gowdy, who's worked extensively for Cisco while at Brobeck and now at Morgan, Lewis. There is "a very good opportunity for us to make a profit on this," says Morgan, Lewis's Molly Lane, a Brobeck alumna and one of two Cisco relationship partners.

Meanwhile, all three contracts include provisions allowing the clients to end the arrangements if they're unhappy with the work.

• **Economies of scale keep costs in line.** Cost management gets easier for larger dockets, since lawyers build an

institutional knowledge of the client and the issues. "If you take a case one at a time, there is no way to gain efficiencies," says Howrey's Ruyak. "But if you have several, you don't have to relearn the client. . . . You don't look at every case that comes in the door as a separate problem."

All three contracts protect the clients from staffing "bait and switch." In their bids, the three firms included resumes for partners who would be available to work on the contract, and they pledged to consult with the companies before making swaps. That said, clients have to understand that attorneys have other obligations and may even leave the firm. Lane says one lawyer on the Cisco contract left Morgan, Lewis to join Senator John Kerry's presidential campaign. It wasn't a problem, she says, because Morgan, Lewis worked with Cisco to select a replacement.

Fixed-fee arrangements can make in-house legal departments more efficient, too. Unocal's Gillespie consolidated the environmental docket under Tracy, who previously had just five

environmental matters, along with Superfund work. Gillespie reassigned the other four counsel who had managed the rest of the environmental docket to tasks such as litigation prevention. Tracy says she was not overwhelmed by the surge in cases she oversees because they were all handled by one firm: Her time spent managing outside counsel and monitoring their bills fell significantly.



MORGAN, LEWIS'S
MOLLY LANE: STILL
REPORTING HOURS

• **Fixed fees encourage collaboration between client and law firm.** Fixed fees eliminate the nagging suspicions that firms secretly relish their client's bad fortune. Cisco's general counsel Mark Chandler says, "Under a fixed fee, [Morgan, Lewis] does not benefit by us getting sued. There were times that the firms I talked to shed crocodile tears when they heard we got sued."

Since neither party worries about racking up fees when they pick up the phone, interchanges are easier. Unocal's Tracy says she has "a lot more frequent contact with Howrey than other outside counsel. In the beginning it was just analyzing existing cases, but now we're knee-deep and can have one call [that will] cover eight cases." She estimates that, depending on the status of cases, she exchanges up to several hundred calls or e-mails per day with the Howrey relationship partners and Robinson, who continues to work closely on Unocal matters.

The clients call often, and more important, they call early. Morgan, Lewis's Howard Holderness, another Brobeck alum and Cisco's other relationship partner, says, "Rather than have the

client wait until the proverbial brown stuff has hit the fan, we get involved much earlier, often before a lawsuit is filed—sometimes immediately when a complaint letter is sent, or even before, when an issue is identified. This is not only helpful for [Cisco]. It is to our benefit as a firm to avoid mass litigation under this contract."

Unocal, Tyco, and Cisco each say they will try any matter they deem worthy of the fight. But only Shook has done so: By early September, it had taken five cases to trial for Tyco. The results have been favorable, with one win; a jury verdict that was vacated following a confidential settlement; a midtrial dismissal; a midtrial settlement; and a post-mistrial settlement. But reducing the number of suits each company faces is central. "I wanted to pay my lawyers to avoid litigation, not just to manage existing suits," says Cisco's Rubin.

• **Fixed-fee arrangements don't mean saying good-bye to time sheets.** Howrey, Shook, and Morgan, Lewis still report their hours to their clients. Those reports help the firm monitor expenses against budget. In their invoices, all three present those figures beside the fixed-fee bill, a legal version of Costco's "see how much you saved."

But sometimes that side-by-side comparison doesn't show a savings, testing a client's resolve to continue

paying for legal services that it might not need after all. Cisco's Chandler says he doesn't mind the periodic disparities. "When the arrangement [with Morgan, Lewis] started, there was nothing in the hopper," Chandler says. "[People asked] 'Why should we pay them this if there's no work to be done?' [Morgan, Lewis] was ahead for the first six months, then started getting behind. For the second year, it came more even, and wound up being pretty comparable to their internal costs. For us, we came out ahead." Morgan, Lewis doesn't view Cisco's gains as its loss, though. Lane says there have been some "tweaks to the contract . . . making sure it works for all sides," though she won't give specifics.

• **Contracts need to be flexible enough to allow for unforeseen problems.** When Tyco set out to move about 500 open product liability claims and suits from 167 firms to Shook—which had not represented Tyco previously—the transfer didn't happen overnight. Shook relationship partner Laurel Harbour says of the handoffs that "some were easy and happy, others were slower." Tyco's head of litigation, James Michalowicz, is blunter: Some of the other firms, unwilling to lose their client, went to their Tyco contacts saying, "You can't do this to us," Michalowicz says. Fewer than half of the case files were in Shook's hands when the contract began on October



CISCO'S MARK
CHANDLER: JUST
RENEWED MORGAN,
LEWIS'S CONTRACT

1, 2004. So Shook's hours in its initial reports were significantly below the projections that the fixed monthly payments were based on. Michalowicz

says that during Shook's first quarterly review in January, Tyco GC William Lytton straightened things out, ordering the GCs at Tyco's various business units to stop undermining the file-transfer process. In retrospect, "two months was too ambitious" for the transition, given internal resistance to change at Tyco, Michalowicz says.

• **Fixed-fee arrangements can provide a strategic edge in litigation.**

When plaintiffs counsel knows legal costs are not a factor for the opposing side, defendants gain a psychological advantage. "In some cases, at the appropriate time, it is helpful for a defendant or potential defendant to be able to say that its legal fees are fixed and therefore are not a relevant criteria in deciding whether or not to litigate," says Cisco's Rubin. "I have said that in settlement conferences, and I believe it makes a difference."

• **Outside counsel can staff matters more efficiently, letting associates cut their teeth on live cases.**

Because Cisco trusts Morgan, Lewis to staff its matters appropriately, says Rubin, "I don't expect Morgan, Lewis to provide a 25-year partner for a small case with minor exposure." Fixed-fee contracts make it cost-effective for clients to turn to their outside counsel for even relatively minor matters, so associates have opportunities to develop close client relationships, trial experience, and a better understanding of the client's business. "We can give smaller things to associates and say, 'Run with this,'" says Morgan, Lewis's Lane. "Generally, we won't get \$30,000 cases from other clients."

The surest sign of success in any lawyer-client relationship is when the client comes back. How do these

three contracts fare by that standard? The biggest question mark looms over the Howrey-Unocal relationship, given Unocal's August merger with Chevron Corporation. At press time Howrey's fate was undecided. Unocal's Gillespie, who will leave the merged company, says that he has visited Chevron "to argue to continue" Howrey's contract. "I certainly hope" that Chevron does so, he adds.

As for the other two fixed-fee arrangements, Cisco's Chandler renewed Morgan, Lewis's two-year contract in August. Shook's contract with Tyco isn't up until April 2006, but Michalowicz says that the prospects for its renewal are good. In fact, he goes quite a bit farther: "I feel quite honestly that this is the best thing that the Tyco law department has done since I've been here." ■

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