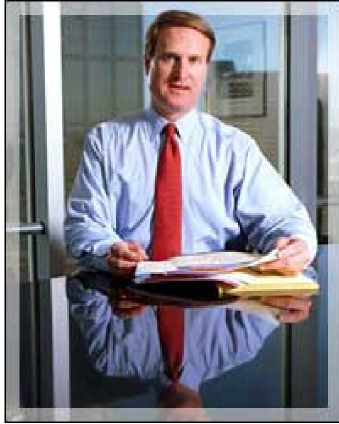
Notes on Complex Commercial Litigation



Welcome to the second issue of *Notes on Complex Commercial Litigation*. Like the inaugural issue, this one aims to help CCL participants – judges, lawyers, and clients – become more successful in their roles by offering them a selection of news, tips, and resources.

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Expediting and Streamlining Commercial Litigation: Take 2

What authority do federal judges have to expedite and streamline cases? When should they use it? And how can fee agreements possibly help make commercial litigation

more efficient?

This month's excerpts from a new chapter on "Techniques for Expediting and Streamlining Commercial Litigation" address these questions. Your Editor wrote the chapter for the upcoming second edition of the ABA Section on Litigation's *Business and Commercial Litigation in Federal Courts*, the definitive work in the area. You may get a copy of the whole chapter by going to www.susmangodfrey.com/bio/bio-bbarnett.html.

Judges' management powers

Federal judges "have the authority to tell lawyers and litigants to do it *my* way, when zealous advocates want to do it *their* way[.]"[1] The authority comes from the courts' "inherent" power—which "'must necessarily result to our Courts of justice from the nature of their institution"—as well as from the Federal Rules of Civil Procedure and the Federal Rules of Evidence, among other sources.[2] Relevant rules permit (and may even require) courts to conduct pretrial conferences and issue scheduling orders,[3] to certify cases for class action treatment,[4] to impose sanctions,[5] to limit discovery,[6] to disregard mistakes or defects unless they affect a party's substantial rights,[7] generally to handle matters in any way they see fit so long as consistent with federal law and local rules,[8] to avoid unjustifiable expense and delay in the reception and presentation of evidence,[9] to exclude relevant but unnecessary

[1] The Judicial Conference of the United States, Civil Litigation Management Manual 1 (2001) (emphasis in original).

[2] Chambers v. NASCO, Inc., 501 U.S. 32, 43 (1991) (quoting United States v. Hudson, 7 Cranch 32, 34 (1812) and affirming district court's imposition of sanctions under inherent authority for bad faith conduct).

[3] Fed. R. Civ. P. 16.

[4] Fed. R. Civ. P. 23.

[5] Fed. R. Civ. P. 11, Fed. R. Civ. P. 37.

[6] Fed. R. Civ. P. 26(b)(2).

[7] Fed. R. Civ. P. 61.

[8] Fed. R. Civ. P. 83.

[9] Fed. R. Evid. 102.

evidence,[10] and to control how parties and counsel present evidence.[11] And several rules authorize judges to enforce agreements between counsel.[12]

Rule 16(c)(12) of the Federal Rules of Civil Procedure may have special importance in commercial litigation. It provides that the court may "adopt[] special procedures for managing potentially difficult or protracted actions that may involve complex issues, multiple parties, difficult legal questions, or unusual proof problems."[13] District courts have cited the rule as authority for addressing a potentially dispositive legal issue early in the case,[14] for enjoining a parallel state action,[15] for requiring "RICO Case Statements,"[16] and for entering an extensive case management order.[17]

The effectiveness of federal judges in using their management powers often determines the cost and quality of the civil justice that parties receive. Once judicial neglect allows a case to get out of hand, in fact, "a judge cannot restore order . . . . It's almost impossible to get the genie back into the bottle."[18] When the parties and counsel do not cooperate, in fact, the court *must* act.

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[10] Fed. R. Evid. 403.

[11] Fed. R. Evid. 611(a).

[12] See, e.g., Fed. R. Civ. P. 29 (allowing parties to make stipulations regarding discovery procedure); Fed. R. Civ. P. 65 (providing that parties may stipulate to extension of temporary restraining order beyond usual time limit); Fed. R. Civ. P. 68 (authorizing offer and acceptance of judgment).

[13] Fed. R. Civ. P. 16(c)(12).

[14] In re HealthSouth Corp., 308 F. Supp. 2d 1253, 1267 n.24 (N.D. Ala. 2004) ("The court determined that the best way to address this complex case is one issue at a time. Thus, the court has authority to address at this early stage the purely legal question of the effect of the severability clause on the insurers' right to rescind.").

[15] In re Lease Oil Antitrust Litig. No. II, 48 F. Supp. 2d 699, (S.D. Tex. 1998) ("In light of this mandate to adopt special procedures to better manage complex litigation, the Court, acting pursuant to the All Writs Act, will enter a preliminary order designed to avoid the conflicts that will inevitably arise if parties in a parallel state action prematurely enter into a settlement agreement which purports to release the exclusive federal antitrust claims which are now before this Court.").

[16] Northland Ins. Co. v. Shell Oil Co., 930 F. Supp. 1069, 1074 (D.N.J. 1996).

[17] Active Products Corp. v. A.H. Choitz & Co., Inc., 163 F.R.D. 274, 277 n.2 (N.D. Ind. 1995).

[18] Levin and Wheeler, Judge Rubin and Judicial Management of the Docket, 52 La. L. Rev. 1489, 1495 (1992) (quoting Circuit Judge Alvin B. Rubin in Colloquy on Complex Litigation, 1981 B.Y.U. L. Rev. 741, 803).

The essential importance of beginning at the outset

Although circumstances will vary from case to case, one principle will apply to all—that your work to expedite and streamline the litigation should begin the first moment of your involvement. As counsel, start out with a fee agreement that puts a premium on advancing the case and a trial team that can win efficiently. You also should immediately make friends with opposing counsel and coax him to accept efficiency-enhancing procedures. Devote yourself to helping the court solve problems, to proposing solutions that will save the court time and effort, and to imposing on the court to decide only those issues determinative of the outcome.

For judges, "[e]stablishing early control over the pretrial process is pivotal in controlling litigation cost and delay."[19] Indeed, "[t]his intervention cannot occur too soon; the process of federal case management, and the role accorded the assigned judge in its administration, argue for the *earliest* exercise of control and oversight to ensure that case resolution comes at the soonest, most efficacious, and least costly moment in every case."[20]

In short, do not delay. Events will overtake you if you do.

* * * *

The chapter's organization "reflects the three relationships that exist in every civil case—between client and counsel, between opposing sides, and between both sides and the court." And it begins by exploring relations between lawyer and client, specifically fees and expenses.

Types of fee arrangements: those that *do* encourage efficiency and those that *don't*

Contingent fee contracts align the interests of the party and counsel who enter into them. The usual arrangement allocates litigation expenses and percentages of any monetary recovery between the party and counsel. If

[19] Civil Litigation Management Manual 5 (footnote omitted).

[20] Civil Litigation Management Manual 5 (footnote omitted).

no recovery results, counsel receives no fee; but he may earn a premium on a large recovery. Counsel and client thus have a mutual interest in maximizing the monetary recovery and expediting resolution of the case through settlement or trial and judgment. If they also share out of pocket costs—typically through reduction of the net recovery that determines the dollar amount of the contingent fee—they also share an interest in keeping litigation expenses low.

Another kind of contingent fee arrangement, far rarer, provides similar incentives for the defendant and her counsel. A "negative" or "defense" contingent fee entitles counsel defending against a claim to receive her fee based on a percentage of the dollar amount representing the difference between what the client pays the plaintiff to resolve the case and the client's probable exposure. (The difficulty of agreeing on how to measure the cost to the defendant — especially in outcomes that include a non-cash component — and the client's probable exposure account for the some of the rarity of negative contingent fees.) If the lawyer achieves an outcome better than the client's likely exposure, the client will pay her a bigger fee in return for sharing the risk of loss. The lawyer may get no fee at all under a pure negative contingent fee arrangement. The defendant and her counsel thus have a joint incentive to prevail on the merits while minimizing waste.

Flat fees put the onus on counsel to achieve efficiency and on the party to get its money's worth. Flat-fee contracts may provide for periodic disbursements (e.g., monthly, quarterly, or annually), an up-front payment of the entire fee, or remittances dependent on the stage of litigation (e.g., before filing a complaint or petition; before decision of a motion to dismiss, to transfer, or for preliminary injunction; before completion of discovery; before the start of trial; or before verdict) or achievement of a specific goal (dismissal or transfer of the case, a preliminary injunction, or a favorable settlement or judgment). The amounts may change or end with the passage of time.

An hourly fee arrangement places the lawyer and client at odds with the system's goal of efficient justice. The lawyer has an incentive to bill for as many hours as the client will bear, regardless of whether the work advances the case towards resolution. The client, on the other hand, understands counsel's conflict of interest and therefore may tend to distrust his judgment and make additional demands on him. The lawyer, in turn, may defer more to the client and may engage in inefficient and unfair (but

ethical and non-sanctionable) conduct to help the client achieve a goal collateral to the merits of the case.

The system benefits from fee and expense arrangements that align the interests of parties and counsel with the system's goals. Contingent and, to a lesser extent, flat fee agreements promote a focus on resolving cases on their merits. Favoring them over hourly engagements will help expedite and streamline commercial litigation.

Some may worry that contingent- and flat-fee arrangements make lawyers lazy and clients apathetic. They suspect that lawyers may not work a case hard enough and will instead hope for a windfall and that clients may let the lawyers control the case.

Our experience doesn't bear out these concerns. We believe the real trouble isn't a tendency of alternative fee arrangements to encourage sloth; it is instead the risk of making a bad deal—one that excessively rewards lawyers for sharing risk and gives them too much control over the lawsuit—or choosing the wrong lawyers—generally ones without a record of success in contingent-fee or flat-fee cases or who don't have adequate resources.

Business clients can avoid bad-deal risk and bad-lawyer risk with "beauty contests". These auditions let clients evaluate law firms and get competitive proposals from them.[21] A beauty contest may involve nothing more than telephone interviews and emails but also may include elaborate in-person presentations by each firm's trial team and submission of detailed bid proposals. These precautions will cut bad-deal/bad-lawyer risk to an acceptable level.

Clients should always insist that each contestant specify its fee proposal. Material terms are the percentages or flat-fee amounts that apply

[21] The availability of information on commercial litigators' expertise and willingness to work on an alternative fee basis has made the job of identifying prospects easier. For examples of services that claim to list outstanding commercial litigators, see www.bestlawyers.com, www.chambersandpartners.com/us/, and www.superlawyers.com. Most lawyers now have Internet sites that describe their experience with different kinds of commercial lawsuits and alternative fee arrangements.

The increasing knowledge and sophistication of in-house counsel also help. General counsel now have available to them, for example, monthly publications such as Corporate Legal Times, websites like http://www.thecorporatecounsel.net/home.asp, and membership in the Committee on Corporate Counsel of the ABA's Section on Litigation and similar groups.

at each stage of litigation, who pays expenses, whether reimbursement of expenses comes before or after calculation of the contingent-fee, the client's right to reject settlement offers, and the circumstances that allow the firm to withdraw (such as in the event the client refuses a reasonable settlement offer).[22]

The effort that goes into the evaluation process will depend on the stakes in the litigation and therefore the potential cost of making bad choices. A small-dollar case that doesn't raise policy questions, for example, probably won't justify a beauty contest. But a big portfolio of little cases or one precursor of a flood likely will. The cost of these efforts pales in comparison to the *much higher* fees the clients will have to pay in a non-competitive environment, regardless of the fee arrangement.

The courts do not generally dictate contractual arrangements between parties and their counsel. And in the salient exception to the rule—class actions—courts often postpone setting the parameters for a fee award until after the lawyers have performed the work for which they seek compensation.[23] But nothing should stop courts from requiring early disclosure of private fee arrangements—particularly in cases involving a claim for recovery of attorneys' fees. The Private Securities Litigation Reform Act ("PSLRA") in fact requires that fees to class counsel "shall not exceed a reasonable percentage of the amount of any damages and prejudgment interest actually paid to the class."[24] The court has the power to require disclosure and ought to exercise it early so that the court – as well as opposing parties and counsel – understand the financial incentives that the fee and expense arrangements create.[25]

Courts, clients, and counsel should likewise encourage arrangements that reward efficiency. Some courts already have implemented auctions and other methods for establishing reasonable contingent fee percentages in class

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[22] See infra Form X-1, which sets out examples of language for a contingent fee agreement.

[23] See, e.g., In re Cendant Corp. Litig., 264 F.3d 201, 254-86 (3d Cir. 2001) (vacating award of fee to class counsel per agreement with lead plaintiff and remanding for reconsideration).

[24] 15 U.S.C.A. § 78u-4(a)(6).

[25] Fed. R. Civ. P. 52(d)(2)(B), for example, empowers the court to require a party seeking to include attorneys' fees in a judgment to "disclose the terms of any agreement with respect to fees to be paid for the services for which claim is made."

action cases.[26] These methods simulate market forces by requiring competing firms to submit bids detailing their experience, resources, and proposed compensation. Some companies, moreover, have developed innovative deals that pay lawyers a premium for handling routine commercial litigation efficiently and at a discount for doing it the other way.[27] Such bargains include negative contingent fees (percentage x [exposure – payment to plaintiff]), flat fees ($X per month, quarter, or year), blended hourly fees (all lawyers, regardless of seniority, charge the same rate), and bonuses for accomplishing specific results (client pays $X if lawyers win summary judgment motion). The trend should continue.

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Did you know?

Big purchasers of price-fixed products can opt out of class cases and use their own counsel to pursue individual claims, often on a contingent fee basis.

Do Insurance Carriers Hurt Efficiency in CCL?

A lawyer who handles CCL mainly for plaintiffs suggests that insurers slow CCL. The civil justice system would make a lot of headway, he asserts, if we found a way to fix their foot-dragging.

[26] See, e.g., Harel and Stein, Auctioning for Loyalty: Selection and Monitoring of Class Counsel, 22 Yale L. & Pol'y Rev. 69, 71 (2004); Third Circuit Task Force Report on Selection of Class Counsel, 74 Temp. L. Rev. 689 (2001); Weiss and Beckerman, Let the Money Do the Monitoring: How Institutional Investors Can Reduce Agency Costs in Securities Class Actions, 104 Yale L.J.2053, 2064-66 (1995).

[27]See, e.g., Grimes, On the Case, Wall St. J. R10, Mar. 31, 2005 (discussing approaches to litigation services and cost by Mark Chandler, General Counsel of Cisco Systems).

[28] The second edition of *Business and Commercial Litigation in Federal Courts* will come out November 8, 2005. If you would like an advance copy of the "Techniques" chapter in manuscript form, please go to [add]. For more information on the forthcoming treatise, please see http://west.thomson.com/news/releases/190_authors.asp.

He has a point. For excellent business reasons, carriers want to postpone funding settlements and discharging judgments. That enables them to invest premium money longer and – they hope – earn bigger profits. Their executive and shareholders reap the benefits.

The addition of an insurance adjuster to the defense team promotes this perfectly rational interest in delay. It tends, for example, to make team interactions more cumbersome; to complicate the defense lawyer's role by giving her two masters – the insurer that pays her bills and the client to whom she owes loyalty; and to slow team decision-making. And in the case of policies eroded by defenses costs – where every dollar of fees and expenses reduces available coverage by a dollar – no one on the defense side has an incentive to demand efficiency from the lawyers representing the insureds.

Does the interest of insurers in putting off settlements and judgments in fact reduce the overall efficiency of CCL? Although no one can say for sure, it very likely does. Indeed, almost nothing in the civil justice system counteracts the profitability of delay to carriers. Unlike the companies and individuals they insure, insurers won't get a public relations black eye or take a hit to their reputations and prospects from a bad outcome in CCL; they won't have to pay more than the dollar limit on their coverage; and they won't have to divert key resources from their business operations to defend against the lawsuit.

What, then, can judges, lawyers, and clients do to overcome insurers' resistance? A tentative answer: give the insureds more leverage in their dealings with their carriers. Possible methods include

- Ordering early settlement conferences or mediations, which encourage parties, counsel, and insurers to evaluate the risks and benefits of litigating versus settling and give insureds an opportunity to apply appropriate pressure on the carriers.

- Requiring carrier representatives who have authority to pay up to policy limits to participate in all settlement conferences.

- Strengthening the right of insureds to recover from insurers the amounts that the insureds must pay *in excess* of policy limits because the insurers refuse to fund a settlement *within* policy limits.

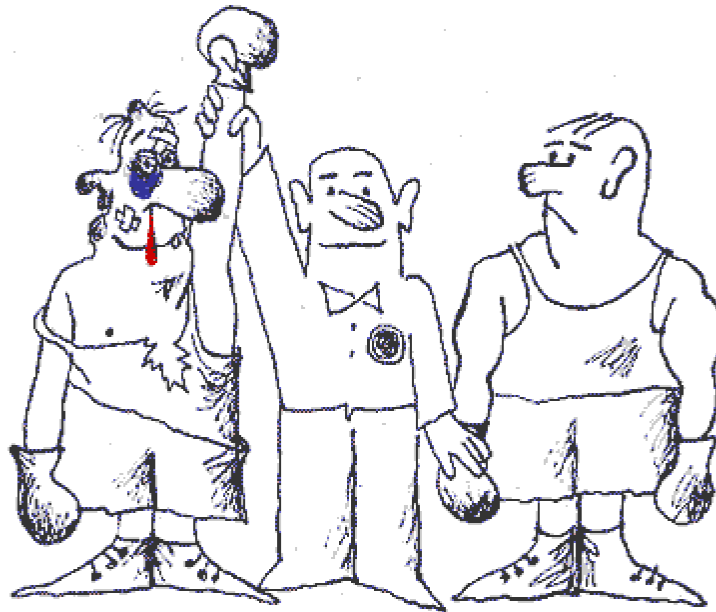
- Enhancing the ability of insureds to collect actual and exemplary damages from carriers that deny coverage in bad faith.

- Allowing insureds to assign claims against their insurers in return for covenants by the plaintiffs not to execute a judgment on the insureds' personal assets.

- Taking cases to trial. As the pre-eminent expert on directors and officers liability insurance[29] points out, unless trials establish a baseline "value" for cases, insureds have a harder time assessing the likely cost of missing a chance to settle at an early stage of CCL.

Each method focuses attention on the insurers' responsibility to protect the insureds and thus more perfectly aligns the insurers' and insureds' interests. Expediting and streamlining CCL should result.

Cartoon



"Thank goodness I had fight insurance."

[29] Tim Burns of Neal, Gerber & Eisenberg in Chicago.

Company Stock and ERISA Plans: A Risky Combination

Pension plans that offer company stock as an investment option or requirement expose plan fiduciaries to significant liability under ERISA. If the fiduciaries allow plan investments in company stock to continue after the stock becomes an imprudent choice, they must compensate the plan for losses it incurs. And those losses may run into the hundreds of millions of dollars or more.

Federal district court decisions have generally allowed imprudence claims involving company stock to proceed, but until recently only one had reached the appellate level. *Kuper v. Iovenko*, 66 F.3d 1447 (6th Cir. 1995). That changed on August 19, 2005, when the Third Circuit held that fiduciaries for the Schering-Plough Employees' Savings Plan may have to pay $138,000,000 to the Plan to restore the asset value it lost when the price of Schering-Plough stock fell more than two thirds during the class period. *In re Schering-Plough Corp. ERISA Litig.*, ___ F.3d ___, 2005 WL 1993990 (Aug. 19, 2005). The Court reversed a rare district court dismissal of the ERISA claims and did so despite defendants' arguments that the plaintiffs couldn't sue on behalf of the Plan because not all participants bought company stock and therefore only some sustained loss.

The *Schering-Plough* decision rejected the contrary conclusion of a Fifth Circuit panel in *Milofsky v. American Airlines, Inc.*, 404 F.3d 338 (5th Cir. 2005). The Third Circuit noted that the Fifth Circuit has granted *en banc* rehearing of *Milofsky* – a step that automatically vacated the panel majority's decision. Adoption of the reasoning in *Schering-Plough* and *Kuper v. Iovenko* by the full Fifth Circuit would make the courts of appeals unanimous on the issue – although it is unclear when the Court will rehear *Milofsky* due to the ravages of Hurricane Katrina.

Susman Godfrey represents parties in pending cases that involve class action claims like those in *Schering-Plough* and *Milofsky*. If you would like more information about ERISA company stock claims, please send a request by email to dmiller@susmangodfrey.com.

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