

# Managing Defense Costs

| A Survey of Trends and  
| Management Strategies

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## Introduction and Executive Summary

Payments by ICI Mutual for defense costs incurred by insured fund groups have soared over the past five years. During the period 1999 – 2003, defense costs paid by ICI Mutual were five times higher than defense costs paid over the preceding ten years. In the past, it was rare for legal fees and other defense costs incurred by fund groups in individual cases to exceed \$500,000. Now, it is not uncommon for these costs to exceed \$3 million.

While the trend towards increased defense costs has been evident for several years, the past year's litigation and regulatory activity is dramatically increasing overall defense costs for the fund industry. It appears unlikely that the current extraordinary level of activity will continue indefinitely. However, the highly publicized events of the past year appear to have left plaintiffs' securities lawyers with the impression that the fund industry is vulnerable, and many observers believe that the industry will face a prolonged period of heightened scrutiny by regulators and plaintiffs' lawyers. It seems likely—given the explosive growth of the fund industry over the past decade and the increasingly visible position of the fund industry in the country's economic and political landscape—that for some time to come, investigative and litigation activity against the fund industry will remain above the relatively benign levels of prior years.

ICI Mutual and its insured fund groups have a common interest in strong and effective defenses in mutual fund-related litigation and regulatory proceedings. As a result, ICI Mutual has historically structured its policies to permit its insureds broad discretion and flexibility in arranging their defenses of lawsuits and regulatory proceedings.

The right of a fund group to control its own defense in lawsuits and regulatory investigations carries with it a responsibility on the part of the fund group to control associated defense costs. Yet too many fund groups have adopted *ad hoc* or passive approaches to managing both litigation and its associated costs. Management of *litigation* has too frequently been delegated, by default, to a fund group's outside counsel; and management of *defense costs* has too frequently been delegated, by default, to the fund group's insurers. In an era when no fund group may rationally view itself as immune from the threat of litigation or regulatory activity, such *ad hoc* and passive approaches are destructive. With such approaches, fund groups fail to realize the many benefits that accrue from strong internal programs for active management of litigation and defense costs. These benefits include:

- *Fewer Surprises.* Where a fund group has a strong program to manage litigation and defense costs, in-house legal personnel—and, in turn, business personnel and senior management—are at decreased risk of being surprised by the inevitable twists and turns of lawsuits and regulatory investigations, or by their eventual outcomes.
- *Less Disruption.* A strong management program permits a fund group to anticipate probable developments in ongoing litigation and regulatory investigations, and to plan ahead so as to respond efficiently and proactively to the predictable demands and requests of plaintiffs, regulators, and the fund group's own defense counsel.
- *Reduced Direct Expenses.* A strong management program permits a fund group to evaluate and control defense expenditures on an ongoing basis, and helps to ensure that the overall level of expenditures is consistent with the organization's evaluation of the importance of the lawsuit or regulatory proceeding.

- *Reduced Insurance Costs.* Defense cost payments now constitute a significant percentage of all liability insurance payments. Because defense costs contribute significantly to insurer losses, these costs must inevitably impact premium rates and/or deductible levels for insured fund groups.
- *Closer Partnership with Outside Counsel.* A strong management program promotes a close partnership between a fund group and its outside counsel, reducing the risk of miscommunications or misunderstandings between a fund group and outside counsel over the fund group’s goals and objectives in litigation and over the appropriate costs to be incurred.

This study (“Study”) is designed to assist ICI Mutual, its insureds and their defense counsel in their joint efforts to promote efficient and effective management of defense costs in litigation and regulatory investigations. The Study focuses on management of defense costs, but necessarily includes discussion of the broader topic of litigation management generally. In particular, the Study is designed to assist senior management and legal and business personnel at fund groups in:

- Appreciating the size and potential severity of costs associated with defending against litigation and regulatory investigations and proceedings;
- Understanding the factors that have contributed to increases in overall defense costs in recent years; and
- Implementing management strategies and techniques—tailored to each fund group’s needs—designed to promote robust, efficient, and cost-effective defenses.

This Study is not intended to and does not suggest any single approach or set of “best practices” for use by fund groups in managing defense costs. Given the diversity of fund groups and the wide variety of lawsuits and regulatory investigations to which fund groups may be subject, it is not practical or advisable to seek a “one size fits all” standard for behavior in this area.

Observations in this Study are derived from ICI Mutual’s detailed interviews with representatives of selected insured fund groups and outside defense law firms, from analysis of defense costs reported to ICI Mutual, and from ICI Mutual’s examination of publicly available information on litigation management and related issues. The Study is divided into three sections:

- *The Rising Cost of Defending Lawsuits and Investigations.* This section reviews the trend towards increasing costs in defending mutual fund lawsuits and regulatory investigations, and identifies various factors contributing to this trend.
- *Principles of Effective Defense Cost Management.* Effective programs to manage defense costs, while varying widely in details, share certain principles. This section discusses these principles, which include (1) strong oversight and involvement by senior management, (2) active partnering between in-house personnel and outside counsel, and (3) regular review and evaluation by appropriate in-house personnel of defense strategies and defense costs.
- *Strategies and Techniques for Managing Defense Costs.* This section describes numerous specific strategies and techniques that may be helpful to fund groups in managing defense costs, and discusses questions that fund groups may wish to consider in structuring their own programs in this area.

# The Rising Cost of Defending Lawsuits and Investigations

Defense cost payments have constituted an increasing percentage of claim payments made by liability insurers over the last decade, “as much as forty percent by some measures.”<sup>1</sup> ICI Mutual’s own claims experience is consistent with that of the liability insurance industry generally. For the period 1990 – 1998, defense costs accounted for just 5% of all claims payments made by ICI Mutual under its D&O/E&O liability insurance policies. By the end of 2003, just five years later, the cumulative percentage had increased to nearly 30%:

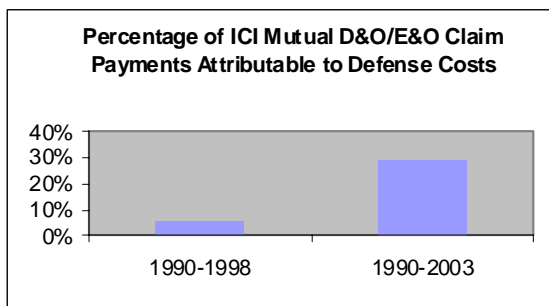


Table 1

If defense costs for the fund industry are increasing on an overall basis, what is the cause of this increase? Is the rise in overall defense costs simply due to an increase in the total number of lawsuits and regulatory proceedings being brought against the fund industry? Or is it due to a growth in the average defense costs incurred per individual lawsuit or regulatory proceeding? As discussed below, both of these factors appear to be contributing to increasing defense costs.

## Increasing Number

After holding relatively steady during the latter half of the 1990s, the frequency of fund-related lawsuits and regulatory investigations has increased since 2000,

spiking sharply during the past year. The past year’s spike, of course, is largely attributable to the intensive scrutiny of the fund industry that began in late 2003 with the New York Attorney General’s highly publicized investigations into market timing and late trading practices. However, for at least the prior several years, numbers of fund-related lawsuits and regulatory investigations had been increasing—a trend that may be explained in part by the explosive growth in industry assets during the 1990s,<sup>2</sup> coupled with growing public attention to mutual funds generally. These two factors have resulted in the fund industry becoming a more visible and attractive target for a highly sophisticated plaintiffs’ securities bar and a subject of greater enforcement attention by regulators.

Although definitive statistics on numbers of lawsuits filed and regulatory investigations initiated against the fund industry are not readily available, a review of the available data suggests a general pattern towards increased frequency of regulatory and litigation activity in the fund industry since at least 2001. Ironically, this increased activity against mutual funds has occurred against the backdrop of a gradual *decrease* in the number of “traditional” securities class actions, not involving mutual funds, filed since 2001.<sup>3</sup>

Three measurements serve as useful proxies to illustrate the overall frequency of lawsuits and regulatory investigations brought against fund groups: (1) the number of notices of potential insurance claims filed with ICI Mutual; (2) the number of fund and adviser-related regulatory enforcement actions brought by the Securities and Exchange Commission (“SEC”); and (3) the number

of shareholder class action and “fee-based” lawsuits filed against fund groups.

## NOTICES OF POTENTIAL INSURANCE CLAIMS

Notices of potential insurance claims filed with ICI Mutual—typically prompted by the filing of a lawsuit or the initiation of a regulatory investigation against an insured fund group—have increased over the past four years, even as the total number of fund groups insured by ICI Mutual has held relatively constant. This growth is reflected in Table 2, which illustrates the annual total number of insurance claims noticed to ICI Mutual (excluding “precautionary notices” of possible future lawsuits or regulatory investigations):

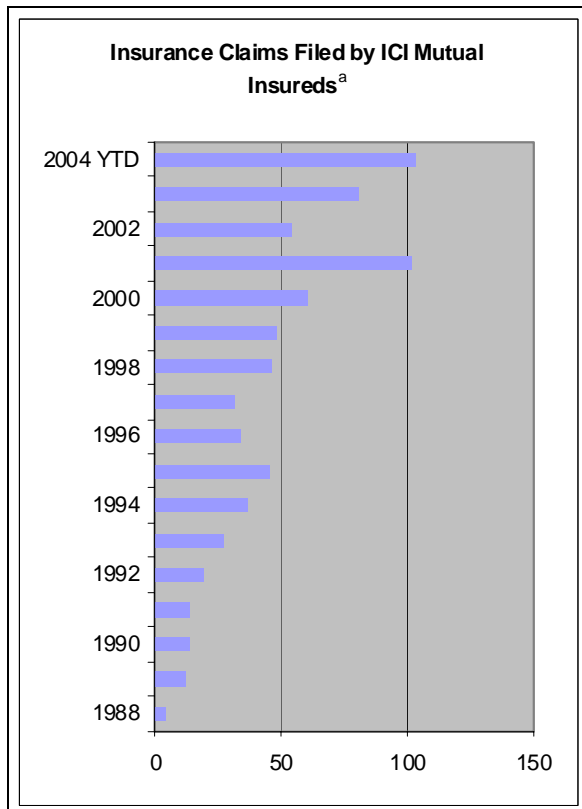


Table 2

<sup>a</sup> Excludes “precautionary notices” of possible future claims.

## REGULATORY ENFORCEMENT ACTIONS

As the fund industry has grown in size and importance as a repository for assets (including retirement assets) of the American public, the industry has attracted increased enforcement attention from regulators, particularly the staff of the SEC. The SEC’s annual reports document an increase in enforcement actions against funds and investment advisers since 1999.<sup>4</sup> ICI Mutual treats regulatory “investigations” (which usually precede enforcement actions) as claims, and has likewise seen an increase in investigations initiated during that same period:

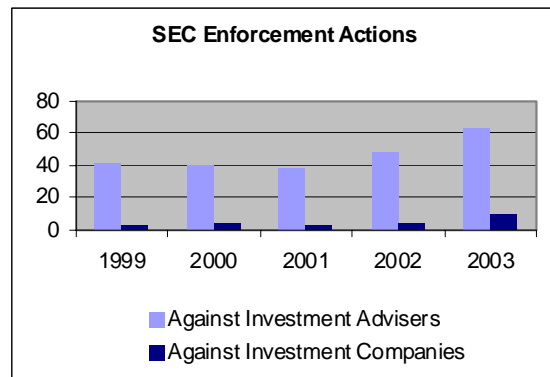


Table 3

## CLASS ACTION AND FEE-BASED LAWSUITS

Another proxy for measuring increased frequency in overall mutual fund litigation can be found in the frequency of two types of lawsuits filed against fund groups: (1) lawsuits brought on behalf of funds against advisers (and in some cases against other service providers or fund directors as well), seeking recovery of allegedly excessive advisory or other fees paid by the funds (“Fee-Based Lawsuits”), and (2) class action lawsuits (other than Fee-Based Lawsuits) brought by shareholders of funds, typically seeking recovery for misstatements or omissions in fund prospectuses or for breaches of fiduciary duty (“Class Action Lawsuits”).

ICI Mutual has reviewed available data on numbers of Fee-Based Lawsuits and Class Actions Lawsuits brought



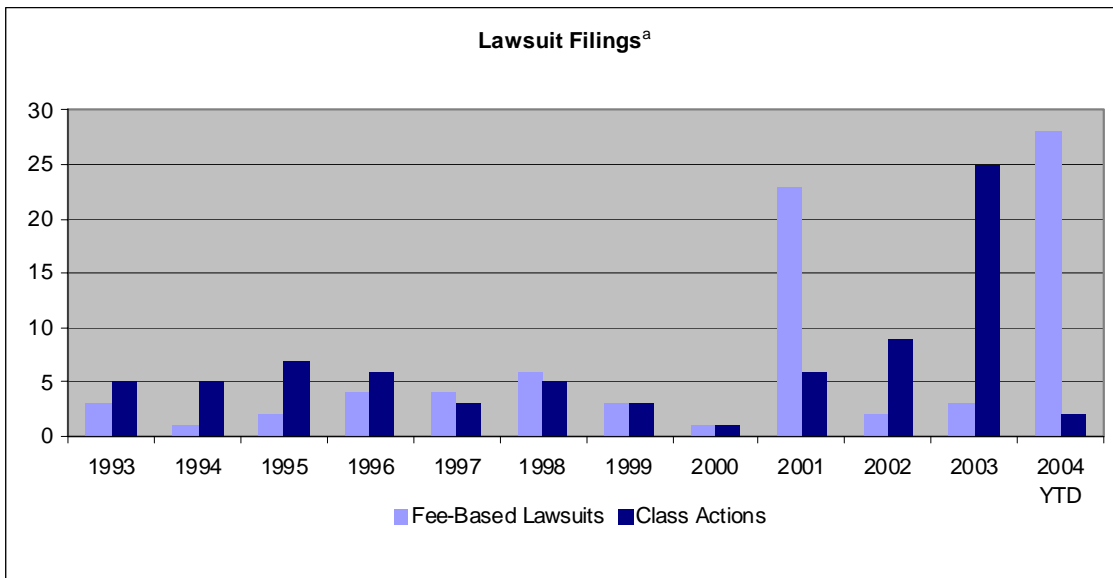


Table 4

<sup>a</sup> “Class Actions” exclude both market timing/late trading lawsuits and fee-based cases structured as class actions. Multiple lawsuits are counted as a single lawsuit where the multiple suits were consolidated or likely to be consolidated, or raised substantially identical allegations against the same fund defendants. Suits that were voluntarily dismissed by plaintiffs before any defendant filed a responsive pleading are excluded. Single lawsuits filed against multiple fund complexes are counted as multiple lawsuits (one suit per complex).

against fund groups (whether or not ICI Mutual insureds) over the past decade.<sup>5</sup> The data suggest that, even *without* counting Class Action Lawsuits filed in 2003 – 2004 related to market timing (which, as “once in a generation” aberrations, might otherwise unduly skew results), numbers of Fee-Based Lawsuits and Class Action Lawsuits, after holding relatively steady through most of the 1990s, have both experienced significant “spikes” during the past four years.

## LOOKING FORWARD

After trying for years to find a way to pursue the fund industry—“like a jackal picking at a tortoise to get inside,” according to one lawyer interviewed for this Study—plaintiffs’ securities lawyers have been encouraged by the recent regulatory and media focus on the fund industry. The plaintiffs’ bar has filed scores of “follow-on” civil lawsuits in the wake of regulatory charges and settlements over market-timing practices

(with most of these civil lawsuits now transferred to multi-district litigation proceedings in federal court in Maryland), as well as large numbers of exploratory and opportunistic lawsuits alleging violations of law relating to other areas under scrutiny, including distribution of fund shares, fair valuation of portfolio securities, and fee levels for advisory and other services. At the same time, federal regulators continue to pursue myriad inquiries into a host of fund industry practices, with a number of these inquiries having evolved or expected to evolve into formal regulatory investigations and proceedings.

It appears unlikely that the current extraordinary level of investigative and litigation activity against the fund industry can continue indefinitely.<sup>6</sup> New activity seems likely to decline as fund groups continue to institute legislative, regulatory, and self-initiated reforms to respond to shareholder and regulatory concerns.<sup>7</sup> Nevertheless, many observers believe that the fund

industry is due for a lengthy period of heightened scrutiny, and it appears likely that for some time to come, levels of litigation and regulatory enforcement activity against the fund industry will remain above the more benign levels of the late 1980s and early 1990s.

## Increasing Cost

The costs of defending individual lawsuits and regulatory actions are not comprehensively tracked by a single source and are therefore difficult to measure with precision. However, there appears to be little doubt—and in-house attorneys and outside defense counsel interviewed for this Study unanimously agreed—that the cost of defending the average individual lawsuit or regulatory action has itself increased, even as lawsuits and regulatory actions against fund groups have become more frequent.

What is the cause of this increase in defense costs for individual lawsuits and regulatory investigations? Is the increase in defense costs simply due to an increase in the hourly rates charged by defense counsel? Or is the increase due to an increase in the total number of hours

required to defend the “average” individual lawsuit or proceeding?

As discussed in the following subsections, both factors appear to be contributing to increased defense costs. Despite efforts by some fund groups to explore use of alternative fee arrangements, the overwhelming majority of defense counsel continue to charge on an hourly fee basis, under which counsel are compensated based on the total number of hours devoted to the defense of a proceeding, and hourly rates charged by defense counsel (along with associated experts and consultants) have increased significantly in recent years. At the same time, numerous factors have contributed to an increase in the total number of attorney hours expended in defense of the “average” lawsuit or regulatory investigation.

### INCREASE IN HOURLY BILLING RATES

As at corporate law firms generally,<sup>8</sup> hourly rates for attorneys at law firms with investment management specialties have increased in recent years. These increases are illustrated by ICI Mutual’s survey of hourly rate increases at three leading investment management defense firms:

**Average (and Range) of Billing Rates at Investment Management Defense Firms**

	1999	2001	2004	Change in the Average (1999-2004)
3 <sup>rd</sup> – Year Associate	\$233 (\$190-\$310)	\$252 (\$200-\$345)	\$282 (\$240-\$380)	21%
1 <sup>st</sup> – Year Partner	\$338 (\$245-\$420)	\$385 (\$275-\$480)	\$431 (\$308-\$525)	28%
Senior Partner	\$445 (\$360-\$565)	\$537 (\$475-\$650)	\$628 (\$540-\$720)	41%

Table 5

Outside counsel consulted for this Study attribute these hourly fee increases to various factors: the need for increased salaries to attract and retain desirable associates;<sup>9</sup> the importance of maintaining per-partner profits so as to retain experienced and expert partners; adjustment of hourly rates to keep pace with inflation; and recoupment of fixed costs associated with ongoing maintenance and upgrades of the extensive technological capabilities that law firms require in order to meet the demands of complex litigation. In part, the increases may also simply be a function of supply and demand: while there are thousands of law firms in the United States, relatively few have specialized expertise in the defense of mutual fund litigation and regulatory investigations.

Similarly, the fees of investment management experts and consultants used in litigation are also generally viewed as having increased in recent years. Again, these increases may in part be a function of supply and demand. As noted by one commentator: “Good experts are expensive and in demand. They lead busy lives and are often located far from trial or deposition sites.”<sup>10</sup> Lawyers interviewed for this Study generally concurred that expert and consulting fees can be a significant driver of defense costs, with one in-house lawyer noting that expert bills can “quickly spin out of control” to the point of sometimes competing with overall bills for defense counsel.

### **INCREASE IN TOTAL HOURS**

Billing rates aside, interviews with in-house attorneys and outside counsel indicate that more attorney hours are now being expended in defense of individual lawsuits and regulatory actions. Factors cited as contributing to this increase include the increased skill and aggressiveness of the plaintiffs’ securities bar; more expansive lawsuits and regulatory investigations; a growing trend towards use of multiple defense firms in individual

lawsuits or regulatory proceedings; and the effect of electronic communications and other technological developments on defense costs, particularly on costs associated with the fact-finding (“discovery”) phase of litigation and regulatory actions.

### **Increased Skill and Aggressiveness of the Plaintiffs’ Bar**

As one factor contributing to increased total attorney hours expended in the defense of lawsuits, some individuals interviewed for this Study pointed to the increased skill and aggressiveness of the plaintiffs’ securities bar. Much of the significant litigation filed against fund groups in recent years has been spearheaded by a relatively small number of plaintiffs’ law firms, who are well-financed from large recoveries in class action lawsuits in other industries and who have turned their attention to the \$7 trillion fund industry as a promising new target for litigation. One defense counsel noted that the ranks of these plaintiffs’ firms are now filled with “lots of good lawyers” compared to earlier times, and that plaintiffs’ lawyers are “just getting better.”

Interviewees suggested that this “far improved” plaintiffs’ bar has become more experienced in mutual fund litigation, resulting in lawsuits that are being crafted more carefully and pursued more aggressively than in the past.<sup>11</sup> As a result, lawsuits against the fund industry are perceived as having become more likely to survive early procedural and substantive challenges so as to proceed to the discovery phase of litigation. Because the cost of defending lawsuits rises dramatically with discovery,<sup>12</sup> lawsuits that can be structured to survive preliminary procedural and substantive challenges involve significantly higher overall defense costs, regardless of their overall merits.

## More Expansive Lawsuits and Regulatory Actions

In recent years, it has become more common for large numbers of funds within a single fund group to be named as defendants in a single lawsuit, and it is not unusual for funds or service providers from two or more unrelated fund groups to be named as defendants in a single complaint. Individuals, including independent directors, are also at increased risk of being named as defendants in lawsuits. Similarly, some defense counsel consulted for this Study have suggested that regulatory investigations frequently involve “higher stakes” than in years past, and require fund groups to provide regulators with more materials and to make more individuals available for testimony. More expansive, contentious lawsuits and regulatory actions typically require greater time commitments from defense counsel, contributing to increasing defense costs.

## Use of Multiple Defense Firms

As the plaintiffs’ bar and regulators have expanded their lawsuits and investigations to include more entities and individuals as defendants or potential targets, it has become more common for fund groups to retain multiple defense firms to represent different defendants or targets in individual lawsuits and regulatory proceedings. It is no longer uncommon for two or more law firms to be retained as litigation counsel in single lawsuits or investigations, in order to represent the perceived separate interests of entities or individuals such as the fund group’s adviser, the funds themselves, independent fund directors, and fund officers and inside directors. The trend has been particularly pronounced for fund groups that utilize “cluster boards,” where separate litigation defense counsel may be retained for each separate “cluster board.”

Use of multiple defense firms is frequently appropriate and necessary to assure vigorous representation of entities or individuals who may have, or who may be

likely to develop, conflicting interests in the defense of the proceeding.<sup>13</sup> At the same time, use of multiple defense firms may sometimes lead, in the words of a New York bar association study on corporate litigation, to “destructive anarchy.”<sup>14</sup> Certainly, use of multiple defense firms almost invariably increases the total attorney hours that must be devoted to the defense of a lawsuit or regulatory action. Even where counsel for different defendants work closely together and one defense firm takes a lead role, use of multiple defense firms means additional hours devoted to communicating among firms, and to reviewing and commenting on the work of the lead firm. The result is increased defense costs for the proceeding and for the fund group as a whole.

## Discovery, and the Effect of Technology on Costs

In general, costs associated with discovery—the fact-finding phase of a lawsuit or regulatory action—comprise the single largest component of overall defense costs. This fact comes as no surprise to litigators, as demonstrated by the proportion of total litigation costs that they typically expect will be attributable to discovery in a given case. Along these lines, ICI Mutual reviewed litigation budgets prepared by six leading defense firms for the defense of different defendant fund groups in the *same* fee-based lawsuit (which named multiple fund groups as defendants). Although the total dollars budgeted for defense of their clients in the lawsuit varied widely among firms, the percentages of overall costs ascribed to various phases of the lawsuits were remarkably consistent from one budget to the next. On average, discovery costs comprised nearly 40% of the total amount budgeted for the litigation (including trial):

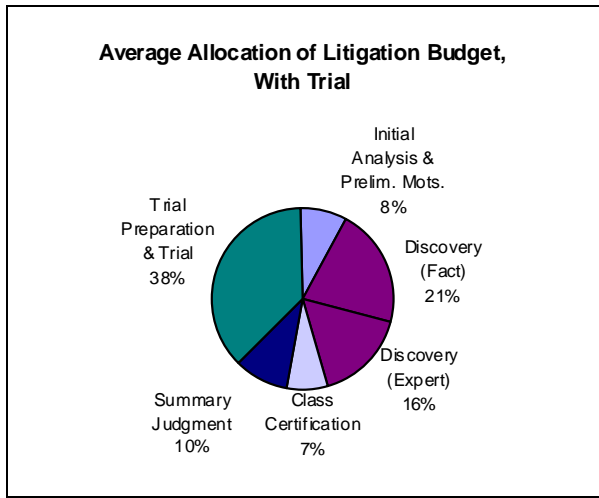


Table 6

In mutual fund litigation, as in corporate litigation generally, very few lawsuits proceed to trial.<sup>15</sup> If consideration is given to this fact, the expected contribution of discovery to overall defense costs incurred by fund groups takes on even greater significance. After removing the budgeted costs of trial preparation and trial, the defense firms expected on average that nearly 60% of their anticipated defense costs would be attributable to discovery:

Perhaps the single most common refrain from interviews conducted for the Study was the effect of technology on defense costs, and specifically, on the costs of discovery.

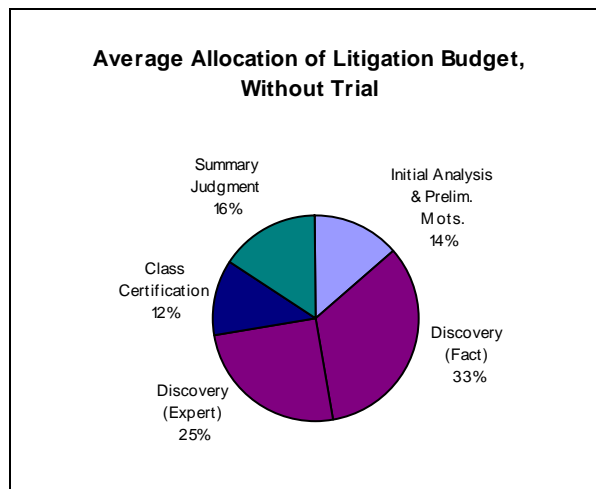


Table 7

Repeatedly, technology was independently volunteered as “the big cost now,” expanding the scope of time required of defense counsel “by many, many orders of magnitude.” Developments in technology over the past decade have resulted in dramatic increases in the sheer number of documents and amount of data created by corporations (such as e-mails<sup>16</sup>), and also in the capacity of corporations to store these documents and data.<sup>17</sup> The increase in retained materials is exacerbated at least in part by the difficulty of deleting electronic data<sup>18</sup> (even where such deletion would be in accord with a proper document-retention policy). The result has been an exponential increase in retained electronic materials.

There is no dispute that such materials (if relevant and not privileged) are discoverable by a litigation opponent.<sup>19</sup> Similarly, regulators have taken an aggressive view as to their right to obtain and review e-mails and other electronic documents during the course of regulatory investigations.<sup>20</sup> The resulting impact on the discovery phase of lawsuits and investigations is relatively straightforward: an unprecedented volume of documents requiring more collection efforts by defense counsel, more review by defense counsel for relevancy and privilege, more production costs, and more preparation time with witnesses prior to depositions.

Technology has also contributed to an increase in discovery costs in other, less visible ways. For example, discovery disputes in a technology age can be more expensive, as it may be necessary to take additional discovery regarding the other party’s practices and technical capabilities with respect to complex electronic document control.<sup>21</sup> It may also be more difficult for the parties to turn to the courts for ready resolution of discovery disputes. In this regard, several attorneys interviewed for the Study noted that technology has made courts less willing to get involved in the details of discovery, with some judges, perceiving the increasing

complexity of discovery as “too overwhelming,” simply “throwing up their hands” and thereby making costs that much harder to control.<sup>22</sup>

All of these factors—more documents, more storage, more complex discovery disputes, more privilege and

relevancy review, and less judicial management—contribute to the same result: “With electronic discovery, the costs mount quickly . . .”<sup>23</sup>

## Principles of Effective Defense Cost Management

Litigation and regulatory enforcement activity against the fund industry has increased in recent years, for reasons discussed earlier. Significant fund-related lawsuits and regulatory investigations can no longer be viewed as unique or extraordinary events. Accordingly, even fund groups with no significant prior history as targets can no longer rationally view themselves as immune from such risk. Indeed, given the size of the fund industry—at over \$7 trillion in assets, the industry is now approximately the size of the commercial banking industry<sup>24</sup>—it is not surprising that the risk of significant litigation and enforcement activity appears to have become a permanent part of the mutual fund landscape.

In this landscape, passive or *ad hoc* approaches to management of litigation and related defense costs are destructive to the interests of fund groups. In an era of increasing frequency and severity of shareholder lawsuits and regulatory proceedings, management of litigation and defense costs cannot be delegated, by default, to a fund group’s outside counsel or insurers. Fund groups that employ passive or *ad hoc* approaches realize none of the benefits afforded by strong internal programs for management of litigation and litigation costs: fewer surprises during litigation, less disruption to the organization and its personnel, reduced direct expense and insurance costs, fewer insurance disputes, and better relationships with outside counsel.<sup>25</sup>

How should fund groups structure internal programs for litigation and defense cost management so as to realize these benefits? Approaches to such programs may vary widely among fund groups, and will necessarily depend upon a number of factors, including the organization’s size and overall litigation risk. Nevertheless, effective programs for management of litigation and defense costs tend to recognize the following three fundamental principles.

### Lawyers Can’t Do It Alone

Oversight and management of litigation and associated defense costs cannot be left solely to an organization’s in-house attorneys and outside counsel. Guidance and involvement by senior management and appropriate business personnel are critical to the success of the effort. An organization’s present and future interests are best served if business personnel—and in more significant litigation, senior management—are actively involved with in-house counsel and outside counsel throughout the litigation in assessing the risks presented, considering the implications of various outcomes for the organization’s short-term and long-term operations, and formulating litigation strategies.

Indeed, some observers have suggested that it is simply unrealistic to expect outside litigation counsel and in-house counsel to effectively control defense costs without oversight and guidance from senior management and business personnel. In this regard, some cynics have argued that outside litigation counsel simply have no incentive to manage costs,<sup>26</sup> while in-house attorneys want “to transfer accountability . . . to the outside firm.”<sup>27</sup> More fairly, both outside litigation counsel and in-house counsel appropriately view their primary responsibility as achieving a “win” for the organization. Absent support and guidance from senior management and business personnel as to acceptable levels of fees and expenses given the risks presented, both outside counsel and in-house counsel will understandably seek to increase the probability of such a “win” by maximizing effort (in the form of time and resources) devoted to the case. Under either view, however, the result is the same: the lawyers can’t do it alone.

## Partnering with Outside Counsel

ICI Mutual has observed that many fund groups take passive approaches to managing litigation and associated defense costs, with these approaches frequently adopted by default rather than by design. ICI Mutual’s observation is consistent with those of outside counsel interviewed for this Study. One outside attorney observed that clients are often “remarkably lax” with respect to even “keeping in touch” once litigation has begun. Another credited in-house legal departments with becoming “more litigation focused,” but observed that in-house departments typically continue to understaff litigation and too frequently view their role as limited to “farming out” the case. With respect to defense costs specifically, one outside attorney confessed that he had “no sense” that some of his clients

were monitoring his initial litigation budgets, and suggested that clients were thereby missing opportunities to detect significant budget deviations and build their awareness as to what activities were driving costs.

Approaching litigation as a fully collaborative effort between appropriate in-house personnel and outside counsel is essential to effective litigation management in general, and to management of defense costs in particular. No matter what terminology is used—“inside ownership” of the litigation, “partnering” with outside counsel, or just “strong management”—the basic concept remains the same: a deliberate decision by a fund group to manage its litigation and associated defense costs, followed through by active engagement and involvement throughout the course of the litigation by in-house personnel.

As part of this collaborative effort, it is important for appropriate in-house personnel and outside counsel to discuss and establish their mutual expectations for management of the litigation and of defense costs. Whether by face-to-face meetings, written “litigation guidelines,” terms of an engagement letter, or otherwise, a key aspect of partnering is setting up expectations in advance. Lawyers interviewed for the Study generally agreed that it is easier to apply cost-management measures that are clearly communicated at the start of the engagement; and, as stated by one in-house lawyer, “outside counsel needs to be comfortable with your level of involvement.”

In sum, a partnering approach permits and encourages both inside personnel and outside counsel—two groups of individuals with different skills, knowledge, and perspectives—to contribute to the solution of a common problem. The result is a strengthened overall defense effort at reduced overall cost.

## Review Objectives, Strategies and Costs

Absent proactive efforts to manage litigation and associated costs, fund groups, like other organizations, tend to lapse into “litigation drift.” Cases proceed without adequate attention as to whether the costs associated with the defense effort are commensurate with the potential benefits of the defense effort to the organization. Even where the eventual outcome of the litigation is otherwise satisfactory, the result may be a Pyrrhic victory, in which the resources devoted to litigation defense grossly outweigh the overall value of the outcome to the organization.

As in many other areas of a fund group’s operations, making decisions as to litigation objectives, strategies and costs involves an ongoing cost-benefit analysis. In some cases, particularly those involving challenges to critical aspects of a fund group’s operations, it will be appropriate to devote a high level of resources to defense efforts. In other cases, a lesser level of resources will be warranted. As discussed below, it is important for appropriate individuals at fund groups—

including outside counsel, business and legal personnel, and in significant litigation, senior management—to evaluate cases regularly during the course of litigation, to ensure that (1) the fund group’s overall objectives for the litigation are being met, (2) the most cost-effective strategies for achieving those objectives are being employed, and (3) the appropriate levels of resources (financial and otherwise) are being assigned to the defense effort in light of the risks that the litigation presents to the organization.

With respect to defense cost expenditures specifically, it is important for ongoing case evaluations to include assessments of both total defense costs incurred to date *and* total defense costs projected through the litigation. Such detailed assessments permit fund groups to determine whether incurred costs are consistent with amounts previously budgeted for the litigation, and, if not, to explore reasons for such variances. Detailed assessments also permit fund groups more accurately to determine whether the overall level of incurred and projected defense costs remains in line with the financial and other risks that the ongoing litigation presents to the fund group.

## Strategies and Techniques for Managing Defense Costs

In their efforts to oversee and manage defense costs, fund groups may wish to consider strategies and techniques that have been identified in the considerable literature on the subject, and in the interviews with fund groups and outside defense counsel conducted for this Study. This section of the Study discusses various of these strategies and techniques, and sets forth questions that fund groups might wish to consider in structuring their own defense cost management efforts.

### Arrangements with Outside Counsel

Fund groups typically retain outside legal counsel for defense of litigation and regulatory investigations. Indeed, even fund groups with considerable in-house litigation expertise generally retain outside counsel in all but the most routine litigation. While recognizing the overriding importance of strong and effective defense



efforts, many fund groups and other businesses also appreciate the need to realize economies and efficiencies in the delivery of defense services. Towards this end, fund groups may wish to focus particular attention on their arrangements with outside defense counsel, including specifically: (1) selection of defense counsel, (2) “front-end” arrangements with defense counsel with respect to fees, costs and staffing, and (3) ongoing consideration and review of projected and incurred defense fees and costs.

### SELECTION OF COUNSEL

*What criteria does your fund group use in selecting defense counsel for particular cases? To what extent do you consider cost of legal services in your selection process? Does your company use an RFP (request for proposal) process in appropriate cases?*

In the words of one in-house attorney interviewed for the Study, “you can’t control the plaintiff, but you *can* control the selection of your lawyer.” In selecting litigation counsel, fund groups, like other corporate clients, seek to assess and balance various considerations. Some fund groups may utilize more formal processes than others in their selection of counsel, in an overall effort to identify and retain counsel whose litigation approach promises best to meet the needs of the organization in the particular case.

Although one consideration that would seem obvious in selection of defense counsel by corporate defendants is the anticipated cost of legal services, some observers have commented on “how little informed price comparison actually takes place.”<sup>28</sup> This is surprising, given that defense costs generated by different defense firms for similar cases may vary widely. Indeed, even within particular law firms, defense costs generated by different individual attorneys for similar cases may vary significantly. In part, these variances can be attributed simply to differences in hourly billing rates between attorneys located in different cities and at different levels of seniority. In part, however, these variances can also be attributed to divergent philosophies among law firms—and among individual lawyers within firms—as to how to approach litigation so as to achieve successful results for their clients.

Within the fund industry, a stark example of these variances may be found by comparing litigation budgets prepared by six leading defense firms for the same fee-based lawsuit (which named multiple fund groups as defendants). Although the relative percentages of overall costs budgeted by these firms for the various phases of the lawsuit were remarkably consistent,<sup>29</sup> the total dollars involved differed significantly among the firms:

LITIGATION PHASE	FIRM 1	FIRM 2	FIRM 3	FIRM 4	FIRM 5	FIRM 6
Initial Analysis & Prelim. Mots.	\$50	\$250	\$40	- <sup>a</sup>	\$300	\$188
Discov. (Including Expert)	\$1,050	\$550	\$450	\$1,500 <sup>b</sup>	\$2,325	\$250
Class Certification	\$150	\$450	\$35		\$275	\$25
Summary Judgment	\$200	\$225	\$133	\$1,250 <sup>b</sup>	\$675	\$75
Trial Prep. & Trial	\$550	\$1,225	\$425		- <sup>a</sup>	\$400
<b>TOTAL</b>	<b>\$2,000</b>	<b>\$2,700</b>	<b>\$1,083</b>	<b>\$2,750<sup>a</sup></b>	<b>\$3,575<sup>a</sup></b>	<b>\$938</b>

All budgets exclude expert fees.

Table 8

<sup>a</sup> Firm did not provide a budget amount for the indicated category. Thus, firm’s total is likely understated.

<sup>b</sup> Firm’s budget combined these categories.

While cost may be important, it is clearly not the only consideration in selecting defense counsel. Particularly in lawsuits that involve high-stakes financial or reputational risks for an organization, other considerations may carry equal or even greater weight. Such considerations include:

- *Expertise.* Many commentators recommend that expertise should be a primary consideration in selection of defense counsel. One general counsel interviewed for the Study stated that separate and apart from litigation skills, she seeks to retain defense counsel with a background or familiarity with investment management law and regulation.
- *Reputation.* “In essence,” according to one commentator, “outside counsel should be chosen on the basis of legal skills and familiarity with the particular area of law rather than by outside counsel’s reputation in the particular jurisdiction.”<sup>30</sup> That being said, particularly in the case of an individual attorney, a reputation often is deserved and accurately reflects both the attorney’s legal skills and expertise in particular areas of law. Giving too much weight to a law firm’s overall reputation as a basis for selection of counsel may be more problematic, however, since very good attorneys may be associated with a law firm of only modest reputation, and vice versa.
- *Familiarity.* Many fund groups have long-standing relationships with particular law firms that have previously represented them in litigation, or that represent them on an ongoing basis in day-to-day corporate and regulatory matters. Retaining such firms in new litigation may itself yield cost efficiencies. While obvious, the point remains a valid one: “over time, a [law] firm develops familiarity with . . . [a] company and its efficiency increases as its law-

yers require less education for each new matter.”<sup>31</sup>

Similarly, over time a fund group develops familiarity with a law firm and the relative strengths and abilities of its individual attorneys, and can make more educated requests of the firm as to appropriate staffing for a particular matter.

Some fund groups utilize a “Request for Proposals” (or “RFP”) process to solicit prospective defense counsel.<sup>32</sup> The RFP process is designed to provide a corporate client with adequate information on which to make an informed decision as to which defense counsel is likely best to meet the client’s needs in a particular case. In corporate litigation generally, “[t]here is little question that RFPs are becoming more commonplace, and if conducted properly, allow clients to balance objectively the relative abilities, merits, and strategies of competing counsel.”<sup>33</sup> In some instances, the RFP process takes place in advance of litigation, and is designed to screen counsel for placement on an “approved list” for handling future cases. In other instances, the RFP process takes place after litigation is commenced, and is conducted to select counsel for the specific litigation. Even for fund groups otherwise inclined to rely on long-standing defense counsel for most of their litigation needs, an RFP process may provide benefits, as discussions with different counsel may alert an organization to different litigation strategies or issues that might not otherwise have been considered.

## FRONT-END ARRANGEMENTS

*Does your fund group establish billing, staffing, and other cost-management expectations at the time of engaging defense counsel? How do you communicate those expectations?*

Many lawyers interviewed for this Study recommended that fund groups seek to discuss and agree with defense counsel upon specific arrangements for staffing, fees,

and other cost-management policies at the time of the engagement. Once defense counsel is retained and the litigation has advanced, a fund group may have less ability to affect defense counsel's customary practices in this regard. Indeed, because staffing, billing, and other administrative arrangements generally have significant economic effects on both defense counsel and the fund group client, fairness to both parties suggests that these arrangements should be fully discussed and agreed upon in advance. The result of that discussion may be memorialized in the engagement letter with counsel, in written billing guidelines, or by some other means. Strategies and techniques particular to such "front-end" arrangements are discussed below.

## Fees and Costs

*Has your fund group considered the incentives that are created by your outside counsel's billing system? Has your fund group considered negotiating alternative billing arrangements or discounts with your outside counsel? Does your fund group require outside counsel to adhere to billing guidelines? Does your fund group require outside counsel to obtain pre-approval for significant expenditures during litigation?*

A well-conceived billing system should encourage efficiency, reward superior performance and align the economic interests of the client and the lawyer. Defense law firms customarily charge for their services based on an hourly fee, a practice which has been frequently criticized as failing to meet these goals.<sup>34</sup> Some firms (including some ICI Mutual insureds) and their defense counsel have explored the use of alternative arrangements in appropriate cases.<sup>35</sup> Such arrangements come in various forms,<sup>36</sup> and include:

- *Flat fee.* Here, the company and its outside defense counsel establish "a predetermined price for each element of the job" (such as for motions, depositions, or document production).<sup>37</sup> In this type of arrangement, the party most capable

of evaluating the risk as to defense costs (namely, the outside defense counsel) is the party that bears it.<sup>38</sup> This arrangement may be especially well-suited for situations in which a law firm has significant experience with the particular type of case, or where a fund group expects multiple similar cases to be filed arising out of the same alleged facts.<sup>39</sup>

- *Mixed fixed/hourly fee.* Here, certain facets of litigation are conducted on a flat fee basis and other facets are conducted on an hourly fee basis. Such an arrangement recognizes the inherent complexities of using a pre-established fixed fee arrangement for certain aspects of litigation (such as discovery), while maintaining the advantages afforded by fixed-fee pricing for other aspects of litigation whose costs are more predictable (for example, preparation of motions).

- *Variations on traditional hourly fees.* Even within the confines of the traditional hourly billing system, some companies seek to control defense costs by negotiating variations on traditional hourly fees. Variations include blended rates (in which defense counsel is paid a specific rate for all hours that are expended on the case, without regard to the usual and various billing rates of each timekeeper at the law firm), discounts (such as a specified percentage off all billings), and lower hourly rates (e.g., "caps" on hourly rates).

Interviews conducted for the Study confirmed that it is common for clients to seek discounts from defense counsel. The market for legal services, after all, is subject to competition like any other market: "Increasing competition forces discounts on billing rates in order for firms to retain their market share."<sup>40</sup> One in-

house lawyer observed that “firms really want to do business with you” and are “willing to negotiate.” Another attorney noted that fund groups “have more leverage than they think,” and that mutual fund litigation is frequently viewed by defense firms as prestigious and attractive work. Outside lawyers have noted that requests for discounts are “fairly widespread,” and that “we now expect a client will demand a break in fees.” Some firms, in effect, utilize a sliding scale of fees rather than fixed billing rates.

Companies also frequently discuss and agree in advance with defense counsel on specific practices relating to fees and costs. Such efforts are frequently welcomed by both client and defense counsel as a means to establish appropriate expectations on both sides with regard to expenses that will be incurred during the course of litigation. Documentation of agreed-upon practices—whether in the form of “guidelines”<sup>41</sup> or “policies” for outside counsel, engagement letters with counsel, or otherwise—can assist in avoiding misunderstandings over expectations that companies and their counsel may have with respect to the following types of questions:

- *Billing Rates.* Will defense counsel’s charges be based on hourly rates or some other arrangement? If hourly rates, will a schedule of hourly rates of all relevant professionals be provided? What caps or discounts, if any, are to be applied to the hourly rates charged? Under what circumstances, if any, may hourly rates be increased during the term of the engagement?
- *Administrative Costs.* What charges will be separately billed to the client and what charges will be considered part of counsel’s ordinary overhead (e.g., support staff salaries, overtime, overtime local transportation, overtime meals, word proc-

essing, LEXIS or other electronic research)? For charges that are separately billed (e.g., photocopying), what mark-up over defense counsel’s actual cost, if any, will be permitted?

- *Presentation of Bills.* How frequently must bills be provided by defense counsel (e.g., monthly)? What billing format will be required (e.g., date of service, name of biller, hourly rate, time incurred, description of activity)? Will billing in electronic format be required? Will disbursements be itemized? Will separate documentation be required for certain types of disbursements (e.g., electronic research) or for disbursements over specified dollar amounts?
- *Prior Approval for Significant Expenses.* Under what circumstances must defense counsel obtain pre-approval from the client before incurring significant expenses? For example, will preapproval be required before hiring expert witnesses? Before travel? Before preparing research memoranda?
- *Travel.* What restrictions, if any, will be placed on travel and related costs (e.g., meals, rental cars, hotels, etc.) incurred by defense counsel? Will counsel be reimbursed for time spent traveling?

At the outset of an engagement, companies may also require defense counsel to prepare an initial litigation budget. As discussed at greater length below, litigation budgets can be very valuable in promoting cost-effective management of litigation, particularly when a budget is reviewed regularly with counsel in light of actual spending during the course of litigation.

Billing systems, billing guidelines, and budgets are simply various manifestations of overall efforts by companies to understand and address litigation expen-

ditures *before* they are incurred. Outside counsel may often appreciate client efforts to clarify such matters in advance. Indeed, a report of a roundtable discussion regarding defense costs included these comments by an in-house lawyer: “[o]ne trend that I have noted is that law firms . . . are checking with us before incurring costs on a case . . . making sure that they are in sync with in-house counsel’s strategy for the case.”<sup>42</sup>

### Front-End Arrangements for Staffing

*Do you understand how counsel proposes to staff the case? Have you identified the particular individuals at your outside defense firm who will be involved in the litigation, and agreed upon what they will do and how much they will cost? Have you discussed with defense counsel the level of involvement that in-house personnel will have in the litigation? Would it be cost-effective for certain tasks to be outsourced to other third parties?*

“To control costs, in-house counsel must understand how the case is being staffed.”<sup>43</sup> In-house lawyers interviewed for the Study generally agreed that law firm staffing, as a substantial factor in defense costs, should be an ongoing consideration during the pendency of litigation. In evaluating staffing, fund groups may wish to focus on how outside counsel intends to staff litigation, to the particular staffing needs that may be met by in-house personnel, and to the possibilities for outsourcing certain tasks to third parties.

With respect to staffing by law firms, a fund group will have difficulty evaluating the likely cost of litigation without knowing which particular individuals at their defense firm will be working on the case, their respective scopes of work, and their individual cost (whether on an hourly basis or otherwise). According to one in-house lawyer consulted for this Study, it is also important to think about how a defense firm will be staffing *each component* of the litigation. A fund group may wish to consider which tasks will typically be performed by a senior partner, and which by less expensive associates,

paralegals, or administrative support personnel. In some cases, fund groups may wish to consider the merits of securing the assistance of a technology specialist to assist with electronic discovery.

Continuity of law firm staffing is also a consideration cited by many of those interviewed for this Study. Along these lines, one outside lawyer warned that “musical chairs” are inefficient and expensive. One in-house lawyer, noting the potential costs associated with “lawyer creep,” stressed the importance of “hiring a lawyer, not a firm.” Another in-house lawyer spoke of having had the need in one case “to sit down” with outside counsel, and investigate why so many people billed time on a single motion.

Staffing discussions may be prospective, as well, with an in-house lawyer discussing in advance which individuals will handle a specific activity and their cost. “That sort of call,” in the words of one outside counsel, “builds awareness” regarding the need to control defense costs. But, he warns, the call must be contemporaneous to the staffing need; “doing it backwards is almost a fruitless endeavor.”

In-house staffing on particular facets of a case also merits consideration as a cost-management strategy. One outside lawyer noted that there could “definitely be a bigger role” for in-house counsel. Indeed, a recurring cost-control strategy that emerged during the interviews and other research for this Study was the performance of litigation tasks internally. “Do as much as you can in-house,” advised one lawyer at a fund group.

The savings is straightforward: activities that can be performed in-house by salaried personnel save the company from being billed for those same activities by outside personnel: “the more the client can do, the lower the cost will be,” said one lawyer. Moreover, in

the words of another, “there are things that in-house lawyers can do much more efficiently than outside counsel.”<sup>44</sup>

Perhaps the single most effective in-house staffing service that can be provided by a fund organization is the designation, at the outset of litigation, of a “point person” within the fund complex who is responsible for liaison functions with the outside firm.<sup>45</sup> Where such a “point person” has significant inside knowledge of the fund group’s structure, personnel and culture, he or she can add immeasurably to the efficiency of the defense effort. With a designated in-house point of contact, outside lawyers can, for example, more quickly solicit necessary documents and information from the organization, and can more easily schedule time for substantive discussions with appropriate in-house personnel.

Discovery may also present a significant opportunity for in-house legal personnel to provide valuable service to the defense effort. One in-house lawyer consulted for this Study described how his staff handled a discovery request for certain e-mails: the company formulated a plan internally with its Chief Technology Officer for retrieving the e-mails, then reviewed the retrieved e-mails for responsiveness to the requests. This saved the company from legal bills for these same tasks. A second in-house lawyer identified hard document collection and indexing as additional discovery activities that can be performed efficiently by in-house personnel. Preparing certain witnesses for deposition is another possibility for cost savings.<sup>46</sup>

Fund groups may also wish to consider outsourcing certain litigation tasks to third parties, such as photocopying, document control, or deposition services. Law firms often submit bills that include fees for such services under a single line item for “expenses.” An alternative approach is to “unbundle” such services

from the law firm. Along these lines, one in-house lawyer advised that his company bids out large copy jobs rather than having the law firm arrange for them. Even certain legal services, such as basic research or more routine tasks, can be outsourced to less expensive counsel.<sup>47</sup>

## ONGOING CONSIDERATION AND REVIEW OF DEFENSE FEES AND COSTS

*Does your fund group require outside counsel to submit litigation budgets? How frequently does your fund group require those budgets to be updated? Do you regularly compare budgeted amounts to actual expenses? Do you discuss any variances with counsel, and seek to understand the reasons behind them? Does your fund group closely review its legal bills? Have you considered use of electronic billing and third-party bill review services?*

Some firms insist on budgeting by outside defense counsel, “knowing that litigation makes sense only if it is cost-effective.”<sup>48</sup> Surprisingly, in ICI Mutual’s experience, many fund groups—while insisting on budgets in other areas of their business operations—make no effort to obtain budgets from litigation counsel unless pressed to do so by their insurers. Even fund groups that ask for preliminary budgets from their counsel may fail to follow up with any budget review.

Certainly, there are challenges associated with preparing litigation budgets (particularly at the early stages of litigation) and budgets may require modification as a case progresses. Nevertheless, budgets that provide realistic, thoughtful estimates of the projected cost of defense counsel’s services, with respect to each of a lawsuit’s phases, can greatly assist both fund groups and their defense counsel in addressing defense cost issues. As with budgeting in any other business area, budgeting in litigation brings discipline and an element of predictability to future expenses. The budgeting and budget review process also provides clients and their

counsel with a structure for agreeing upon appropriate allocation of resources towards the defense effort.

These benefits are doubly realized if budgets are updated and reviewed throughout the pendency of litigation. One fund group interviewed for the Study, for example, requires budgets from outside counsel, and compares the budget to actual costs on a monthly basis, discussing the reasons for any variances with counsel. Several in-house lawyers interviewed for the Study remarked that litigation budgets become more realistic as outside counsel gain experience with the budgeting. Regular review of budgets by in-house personnel, coupled with discussions with outside counsel as to reasons for any variances, can also help fund groups and their counsel to avoid unnecessary surprises and disputes over billings. Along these lines, one outside lawyer interviewed for this Study observed that ongoing budgeting and review of variances is much more effective than “an eighteen-page letter reviewing three years of bills.”

Client review of law firm bills has been the subject of a substantial amount of commentary. Close attention to bills submitted by defense counsel is now commonly recognized as a staple of controlling costs. As stated by one in-house attorney consulted for this Study, “they knew they weren’t going to get paid unless we talked first.”

Review of defense counsel’s billings seeks to confirm, as a preliminary matter, that minimum particulars are reported on the bill, like itemization of the individual performing the service and the rate charged.<sup>49</sup> Such a preliminary review can result in the identification of obvious mistakes. Once basic particulars underlying a bill are in hand and obvious mistakes are identified, bills may be reviewed for issues meriting further discussion with defense counsel, including lack of specificity in individual time entries (e.g., vague billing entries, such as

“review file”), staffing inefficiencies (e.g., too many lawyers, or unnecessarily senior lawyers, attending a deposition), or questionable work (e.g., too many hours billed for a particular task).<sup>50</sup> “Sometimes there may be an explanation,” one in-house lawyer observed. But billing inquiries just as often result in reduced charges, and “outside counsel will be more vigilant.”

Review of bills may also include an evaluation of the overall reasonableness of the defense counsel’s total fees. A company need not be shy in this regard, as reasonableness in fees charged is generally considered to be a professional responsibility of counsel.<sup>51</sup> At the very least, said one in-house lawyer, a close review of bills sends a signal to outside counsel that the level of defense costs is a matter of concern to the client: “I look at bills, just so they know I’m doing it.”

A “cottage industry” of legal accounting firms has now emerged to assist companies with their evaluation of defense bills.<sup>52</sup> Such firms use a variety of “data mining” techniques to identify mistakes or questionable billing practices. Some of these firms also use their broader experience in the area of evaluating bills to assist their clients in evaluating overall reasonableness of fees. Some corporate clients have begun to call for bills to be presented by counsel in specified electronic formats to facilitate computerized billing review by legal accounting firms.<sup>53</sup>

## Oversight and Management of Litigation

Separate and apart from a focus on arrangements with counsel, various measures taken during the course of litigation (or regulatory investigations) can assist fund groups in realizing economies and efficiencies in the overall defense effort. Some of these measures should be considered at or near the commencement of

litigation, while others may be deferred to later stages of litigation. Most of these measures are manifestations of a principle discussed above—namely, the importance of engaging in an ongoing review of litigation objectives, strategies, and costs.

## CASE ASSESSMENT

*Does your fund group conduct a formal case assessment at an early stage of new litigation? Do you seek to establish your fund group's objectives in the litigation, your overall strategies to achieve those objectives, and the level of resources to be devoted to defense efforts? How frequently do you revisit these issues during the course of the litigation? Do you conduct a post-litigation review?*

As discussed above, an organization's present and future interests are best served if appropriate business personnel—and in significant cases, senior management—are regularly and actively involved with in-house counsel and outside counsel throughout the pendency of litigation in assessing the risks presented, and formulating litigation objectives and strategies. In the absence of such regular attention, cases too often lapse into “litigation drift,” proceeding for months or years without adequate attention as to whether the costs associated with the defense effort are commensurate with the potential benefits of the defense effort to the organization. Frequently, the end result of such drift is unnecessarily high defense costs, a longer duration for the litigation, greater burdens on management, and an eventual outcome that may be at odds with an organization's best interests.

Many observers have stressed the importance of conducting an initial “case assessment” at an early stage of each new proceeding.<sup>54</sup> As one commentator has noted, “the lowest costs are achievable by the most intelligent management of the lawsuit: early and full analysis of the litigation risks . . . .”<sup>55</sup> A formal case assessment at or near the commencement of litigation permits a defendant company to establish clear objec-

tives for the litigation,<sup>56</sup> including consideration of whether a settlement orientation should be adopted.<sup>57</sup> An initial case assessment also permits the defendant company to establish, at least on a preliminary basis, the appropriate level of resources—in the form of outside counsel fees and dedicated in-house resources—to be devoted to the defense effort.

Relevant business personnel—including, in appropriate cases, senior management—bring valuable insights to the case assessment process, as do in-house counsel. “We’re the ones who know the facts,” according to one in-house lawyer, including “where the dirty linen is.” Participation by outside counsel is also important, both so that outside counsel may be educated as to the relevant underlying facts and issues (“disclose everything,” one lawyer instructs his clients), and so that outside counsel may assist the organization in its efforts to explore the strengths and weaknesses of its position. Several lawyers interviewed for the Study noted the potential advantages, in appropriate cases, of soliciting an early evaluation of litigation by an objective, neutral third-party specifically engaged for that purpose. Such a third party perspective can serve as a useful “reality check” and can assist organizations in considering whether a settlement-oriented strategy may be advisable in a particular case.

Because litigation (and regulatory investigations) may frequently evolve in unexpected directions, fund groups may wish to arrange for case assessments to be held on a regular basis throughout the pendency of a proceeding. As one outside lawyer cautioned, because “every case has its own pathology,” it is important to “re-assess strategy often.” Such regular reevaluations ensure that an organization stays current on the risks presented by the proceeding, and permits the organization to make appropriate decisions as to defense strategies and



to dedicate defense resources commensurate with the risks presented.

Finally, as is often the case at the conclusion of any undertaking, a *post*-litigation assessment can bring valuable insights to an organization. Such an assessment may include, for example, review of the substantive performance of defense counsel and inside personnel during the course of the proceeding, consideration of the strengths and weaknesses of strategies employed, and evaluation of the cost-efficiency of the defense effort. As part of such a post-proceeding assessment, a fund group may wish to solicit the views of outside counsel as to how in-house efforts could be improved in future cases.<sup>58</sup> One lawyer interviewed for the Study cautioned against the temptation to just “move on,” noting that a retrospective look can assist a fund group in being prepared if similar issues arise in the future.

## PROCEDURAL OPTIONS

*Does your fund group consider early settlement in appropriate cases? Does your fund group consider the use of alternative dispute resolution approaches, such as mediation or arbitration?*

Historically, the fund industry has been highly successful in achieving early dismissals of lawsuits, based on legal arguments made to courts prior to the discovery stage of litigation. In lawsuits that survive such early legal challenges, however, fund groups frequently incur vast time and expense in litigation only to enter into settlements prior to trial. In this regard, fund groups are no different than other corporate litigants. “Statistics show that well over 95 percent of all litigation settles. However, as experienced litigators know, settlement is too often reached at the ‘courthouse steps’ after the parties have spent large amounts of money, emotion and time conducting discovery and preparing for trial.”<sup>59</sup>

However inefficient it may be as a mechanism to resolve disputes, the traditional course of litigation—“complaint-answer-motion-discovery-motion and then, for about 97 percent of cases, settlement just prior to trial”<sup>60</sup>—is frequently the only logical course of action for a corporate defendant. In many cases it is only through a vigorous and prolonged defense that a corporate defendant is able to achieve a rational settlement. Thus, the presentation of persuasive legal arguments in initial motions, the development of favorable facts through discovery, and the delivery of convincing expert testimony are frequently required in order to convince a claimant to “be realistic”—that is, to accept a settlement that accurately reflects the corporate defendant’s true exposure in a particular case.

In at least some cases, however, fund groups may wish to consider procedural alternatives to the traditional course of litigation. One procedural alternative is to remove a dispute from the courts through vigorous efforts to achieve a settlement at an early stage of the proceeding. While often anathema to a corporate defendant’s sense of fair play and justice, “paying up” to achieve an early settlement in traditional litigation may sometimes be the most cost-effective and rational solution to a dispute. In particular, early settlements may be warranted where the costs of defending the lawsuit are likely to exceed any expected savings that would be achieved by settling at a later date.

A second procedural alternative is to use some form of alternative dispute resolution (“ADR”), most commonly mediation or arbitration. ADR has long been touted as a faster and lower-cost approach to traditional litigation, and though doubts have been raised by some as to ADR’s effectiveness “in delivering relief from litigation costs,”<sup>61</sup> ADR has strong adherents and some companies apparently use some form of it as their “primary litigation management tool.”<sup>62</sup> One in-house

lawyer interviewed for the Study noted that plaintiffs' lawyers may like ADR "because they get their fees faster."

## DISCOVERY

*Does your fund group have written document retention policies and procedures? Do they address electronic documents, such as e-mails?*

*Does your fund group negotiate limits on the scope of discovery?*

*What steps does your fund group take to manage the costs of electronic discovery?*

As discussed earlier in this Study,<sup>63</sup> the fact-finding (or "discovery") phase of litigation comprises the single largest component of overall defense costs. Given the disproportionate impact of discovery on defense costs, many corporate defendants have targeted this phase of litigation for special management efforts.

Many commentators recommend development of a records management strategy long before any litigation is threatened: "[I]f implemented before a lawsuit is filed, a reasonable document/retention policy and electronic discovery response plan will make the electronic discovery process less burdensome when that inevitable discovery request drops on counsel's desk."<sup>64</sup> Indeed, gaining "much better control" of electronic information has been described as a "best practice," in that "[c]ompanies can significantly reduce the overall cost of electronic discovery and the risk of spoliation sanctions by embracing e-records management."<sup>65</sup>

Lawyers consulted for this Study were in accord with this view, with one expressing hope that advances in records management systems may prove successful in reducing the burden of electronic discovery in the future. One example cited—fighting technology with technology—was improving search and retrieval capability. In this regard, one complex has implemented a robust e-mail search engine and expects that, in the

next litigation, the outside law firm will need only "look at 5,000 or 10,000 e-mails, instead of 50,000."

More generally, several lawyers interviewed for the Study stressed the benefits of adherence to a written document retention plan. Formulation and adherence to document retention plans that are consistent with applicable law and regulation can significantly reduce the burden of discovery once a lawsuit occurs. In agreement, one in-house attorney commented that people "are not cleaning out their files enough," noting with dismay some attorneys' habit of keeping "fourteen drafts of each prospectus in the file." In one lawsuit, she reported, her company spent "weeks and weeks" reviewing documents that should not have been retained. Another lawyer noted that one reason e-mail discovery is "phenomenally expensive" is because people unnecessarily "keep so much of it."

Once a proceeding is commenced, other techniques may also be helpful in managing the burdens of discovery. Litigators commonly appreciate "that whatever you ask for in discovery, you will be asked for in return."<sup>66</sup> Thus, it may be in the economic self-interest of a corporate defendant to consider a case management plan that puts limits on discovery, and to seek the opposing party's agreement to such limits. Discovery limits negotiated in advance between parties might include, for example, limits on the following: the scope of electronic discovery; overall numbers of interrogatories, documents requests, or depositions; the duration of each deposition; and/or the subject matters of inquiry by each side. In some cases, negotiation over discovery limits will naturally segue into a narrowing of the overall focus of a given dispute: as one corporate counsel has noted, "we usually meet very early in the case with opposing counsel to determine whether the case can be narrowed, and whether something short of

full-blown litigation can be used to bring the parties together before unnecessary costs are expended.<sup>67</sup>

Cost management in *electronic* discovery involves special challenges. Technological developments over the past decade have resulted in dramatic increases to the number of electronic documents (including e-mails) created and retained by corporations, and has made discovery significantly more complex and time-consuming.<sup>68</sup> One outside lawyer interviewed for the Study suggested that lawyers and clients are still “just reacting” to the dramatic effect that technology has had on discovery, and have not yet developed good mechanisms to control associated costs. Nevertheless, fund groups and their outside counsel have been sensitive to the significant expense associated with electronic discovery, and in-house and outside counsel interviewed for the Study offered several general strategies that fund groups may wish to consider in seeking to control this expense:

- *Cost Shifting.* Although the party responding to a document request generally bears the cost of gathering the responsive documents, several outside lawyers consulted for the Study reported success in shifting to plaintiffs the cost of responding to burdensome or overbroad electronic discovery requests. In one case, a lawyer reported, he used the mere filing of a cost-shifting motion as leverage to negotiate a significantly curtailed discovery request. Both courts and commentators seem increasingly open to this possibility of shifting costs to the requesting party,<sup>69</sup> especially when the requested electronic data is relatively inaccessible (as with back-up tapes).<sup>70</sup>

- *Staffing and Outsourcing Decisions.* Some counsel report significant cost savings can be achieved through staffing decisions specific to electronic discovery, including outsourcing of appropriate

tasks. Thus, some interviewees have made conscious efforts to assign first-level review of e-mails or other data to lower-cost law firm personnel (e.g., contract lawyers, paralegals, career “document clerks”) rather than higher-priced law firm associates. Others have suggested use of a dedicated technical staff within the mutual fund complex itself to spearhead the collection of electronic data. Outsourcing was also cited as a potential mechanism for cost-savings, particularly given price competition within the growing cottage industry of consulting firms who compile and sort electronic data for law firms.

- *Oversight of Discovery Disputes.* While success in certain discovery disputes may be important to the overall defense effort, many discovery disputes may reflect nothing so much as zealous representation by counsel. Oversight by relevant in-house personnel of disputes over electronic discovery can have an impact on defense costs. As observed by one commentator, in-house counsel will “quite often” need to “step into a certain discovery dispute in order to reduce the economic impact.”<sup>71</sup>

## EXPERTS AND CONSULTANTS

*What steps does your fund group use to manage the cost of experts? Does your fund group use in-house experts where feasible? Does your fund group seek to limit the use of experts?*

Noting that fees for experts and consultants can be a significant driver of defense costs, one lawyer interviewed for the Study suggested that management of experts and consultants merited equal attention by fund groups to management of outside counsel. As one in-house lawyer commented with respect to consultants, “the hole will open up and swallow you alive if you do

not manage it.” Thus, many of the techniques and strategies set forth above regarding outside counsel—e.g., selection, negotiation of fees, budgeting, pre-approval of significant costs, and bill review—apply equally to experts and consultants.

Other strategies that fund groups may wish to consider in connection with selection and use of experts and consultants include the following:

■ *Is retention of an expert required?* In some cases, the need for expert testimony cannot be avoided. But in other cases, less expensive approaches may be available. In particular, organizations may have the needed expertise in-house, eliminating or reducing the need for experts. Thus for example, one lawyer interviewed for this Study suggested that there is often in-house expertise at mutual fund complexes to perform modeling (e.g., if we did this, what would happen?). Another in-house lawyer stated that, with respect to the disputed issue in one case, “we knew more about it than the consultants,” and observed that in hindsight he thought it might have been more efficient had the expert merely reviewed an analysis performed internally.

■ *Is the candidate the correct expert for the job?* If a decision to hire an expert is made, an organization should be sure to investigate the person’s expertise and reputation. Money can be wasted not only by hiring an expert who lacks sufficient knowledge,<sup>72</sup> but also by hiring an overpriced prima donna unwilling to “dig in.”<sup>73</sup>

■ *When should the expert be retained, and what should be the scope of the retention?* One outside lawyer consulted for the Study suggested “holding back” on an expert until “the last minute,” at which point

the expert’s time will be spent more efficiently by necessity, in order to meet litigation deadlines.

While it may be preferable in many cases to identify and decide on an expert well in advance of the time he or she is needed, once an expert is retained, it may be appropriate to focus the expert’s attention on a limited number of specific issues: “[R]ather than have the expert review the file generally, direct the expert to specific areas where you see potential problems. . . . A focused review is usually more productive.”<sup>74</sup> One lawyer interviewed for the Study agreed, advising that an expert should review particular issues, such as whether disclosure had an effect on the market. Another interviewee emphasized that the importance of “decid[ing] right up front what you want from them” (e.g., a report, testimony, pure factual data, informal opinion); and suggested that experts be provided with “a full and fair record, but not the whole file.”

■ *Can limits on expert discovery be negotiated?* As with discovery generally, several lawyers consulted for this Study recommended negotiating expert discovery limits, such as limits on the number or length of expert depositions. One of them noted that plaintiffs’ attorneys often have an incentive to negotiate such limits because they are working on a contingency basis. Another lawyer cited success in some of his cases with experts providing written direct testimony in lieu of live testimony, such that only cross-examinations would need to occur during trial.

## COMMUNICATION WITH INSURERS

*Does your fund group keep its insurer(s) apprised of the status of pending litigation? Does your fund group consult with its insurer(s) on defense cost management and related issues?*

Fund groups should keep their insurers fully informed about the status of defense efforts, including billings, strategy, and developments in the underlying matter. Indeed, the provision of complete and timely information to insurers is generally required under terms of relevant insurance policies, and can help to avoid insurance disputes and increase the likelihood of prompt insurance recoveries for defense costs, settlements, and judgments.<sup>75</sup>

Some insurers, including ICI Mutual, also seek to provide their insureds with substantive assistance in underlying litigation and in efforts by insureds to manage litigation expenses. Thus, for example, ICI Mutual has worked closely with numerous insureds and their defense counsel by coordinating educational

sessions, actively assisting counsel in various technical areas, and serving as a clearinghouse of legal developments in different categories of pending litigation. ICI Mutual has also provided insureds with guidance on management of defense costs, as part of an effort to assist insureds in their own cost management efforts.

One in-house attorney interviewed for the Study commented that quarterly discussions with ICI Mutual regarding defense billings and major case developments have proved helpful, noting that ICI Mutual “talked the same language” as the defense firm. Another noted that his company benefited from ICI Mutual’s experience with substantially similar prior claims brought against other fund complexes.

# Endnotes

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<sup>1</sup> Susan Randall, *Litigation Cost Controls and the Professional Obligations of Insurance Defense Lawyers*, 60 ALA. LAW. 336, 336 (1999).

<sup>2</sup> By 2001, nearly \$7 trillion was held by mutual funds, approximately ten times the total in 1986. SECS. INDUS. ASS'N, 2002 SECURITIES INDUSTRY FACTBOOK 59.

<sup>3</sup> See CORNERSTONE RESEARCH, 2003: A YEAR IN REVIEW 2 (2004) (“After removing special cases . . . , there were 175 ‘traditional’ securities class action suits filed in 2003. The number of suits filed in 2003 was 22 percent lower than the number of cases filed in 2002 [225] and 9 percent lower than the 1996 to 2002 average [192].”) (brackets in original).

<sup>4</sup> The SEC’s annual reports for 1999 through 2003 are available at <http://www.sec.gov/about.shtml>. Statistics regarding enforcement actions for each year are in the appendix for that year’s report. Although the appendixes do not likewise report the number of mutual fund-related investigations, it does report the overall number of all investigations relating to all acts administered by the SEC. In 1999, the SEC opened 520 investigations of possible violations; and in 2003, the SEC opened 910 such investigations.

<sup>5</sup> The data set reviewed for this Study consists of (1) cases reported in ICI Mutual’s Litigation Notebook (an annual compilation of lawsuits and public enforcement proceedings filed against fund groups) and (2) any other mutual fund lawsuits for which ICI Mutual received notice from its insureds.

<sup>6</sup> See Brooke A. Masters, *A Year of Charges, Reforms for Funds*, WASH. POST, Sept. 1, 2004, at E1 (“Federal, state and industry regulators say that they believe they have uncovered the worst of the abuses and that most of the really large cases have already been settled. . . . ‘The scandal is basically over. . . ,’ said Bentley College finance professor Leonard Rosenthal.”).

<sup>7</sup> See *id.* (“Four congressional committees have held meetings, and the SEC has passed or proposed new rules covering fund governance, pricing and disclosure. The industry also has begun implementing changes.”).

<sup>8</sup> “Hourly rates at most law firms have increased dramatically in recent decades.” Scott Atlas, *Where Have All the Trials Gone?*, LITIG., Summer 2002, at 1, 2. In the late 1990s, according to one study, hourly rates in corporate law firms increased between 3.6% to 7.3% per year. Gillian K. Hadfield, *The Price of Law: How the Market for Lawyers Distorts the Justice System*, 98 MICH. L. REV. 953, 958 (2000). According to another, the trend since 2000 “has been to increase the [hourly billing] rate by more than 10 percent” (although now typically waiting more than one year between changes). Austin Anderson, *Economics of Law Practice: Coping with the Economy*, MICH. B.J., Feb. 2004. According to IOMA’s 2003 Law Firm Management Survey, “more than one-third of law firms have increased their partners’ hourly billing rates, 38% have increased their associates’ hourly billing rates, and 26% have increased their legal assistants’ hourly billing rates.” *Getting the Best from Your Legal & Financial Advisors*, PRINCIPAL’S REP. (Inst. of Mgmt. & Admin., New York, N.Y.), Mar. 2004, at 1.

<sup>9</sup> According to one study in 2000, the median salary for first-year associates ranged from \$60,000 (in firms of 2 to 25 attorneys) to \$110,000 (in firms of 500 attorneys or more). Compared to 1999, those figures reflected “a dramatic increase in first-year salaries, especially in larger firms.” Press Release, Nat’l Ass’n for Law Placement, Entry-Level Associate Salaries Rise Sharply (Aug. 28, 2000), <http://www.nalp.org/press/asr00.htm>.

<sup>10</sup> Luke Pittoni, LEGAL TECH. NEWS, Jan. 9, 2004, at 13.

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<sup>11</sup> See generally Steven Andersen et al., *The Events, People & Stories That Impacted Your Life in 2003*, CORP. LEGAL TIMES, Dec. 2003, at 1 (“[E]xperts believe shareholder suits were far more contentious, creative and disruptive [in 2003] than in years past.”).

<sup>12</sup> See *infra* p. 11 (regarding discovery and the impact of technology on costs).

<sup>13</sup> See MODEL RULES OF PROF'L CONDUCT R. 1.7(B) (“A lawyer shall not represent a client if the representation of that client may be materially limited by the lawyer’s responsibilities to another client or to a third person . . . unless . . . the lawyer reasonably believes the representation will not be adversely affected . . .”).

<sup>14</sup> Corp. Couns. Sec., N.Y. State Bar Ass’n, *Report on Cost-Effective Management of Corporate Litigation*, 59 ALB. L. REV. 263, 309 (1995).

<sup>15</sup> See Michael Wilk, *Mediation of a Bankruptcy Case*, AM. BANKR. INST. J., May 2003 (“Statistics show that well over 95 percent of all litigation settles.”); Leo J. Jordan, *A Parallel Course for HMOs and Insurance Litigation Cost Management?*, BRIEF, Winter 2000, at 57, 60 (describing the customary path of litigation as “complaint-answer-motion-discovery-motion and then, for about 97 percent of cases, settlement just prior to trial.”).

<sup>16</sup> J. Ric Gass, *Making “Partnering” Work for Civil Justice Reform*, METRO. CORP. COUNSEL, Nov. 2003, at 47 (“[T]he use of electronic mail has increased exponentially . . .”).

<sup>17</sup> Patrick J. Burke & Daniel M. Kummer, *Controlling Discovery Costs*, N.J.L.J., Sept. 8, 2003 (“[M]ost companies store their electronic documents in any number of systems—corporate servers; employee hard drives; intranets and extranets; outsourced e-mail providers; and consumer electronics with storage capabilities, like personal digital assistants. And multiple copies of each are stored on backup tapes.”); Eric Van Buskirk, *Raging Debate: Who Should Pay for Digital Discovery?*, N.Y.L.J., Jan. 27, 2003, at T4 (“[C]omputer technology permits parties to retain greater amounts of data . . .”).

<sup>18</sup> Van Buskirk, *supra* note 17, at T4 (“[D]igital information is difficult to eradicate—the ‘deletion’ of files is usually not equivalent to their permanent removal.”).

<sup>19</sup> Indeed, given “the ever-increasing role of electronic evidence,” some courts may even “impose affirmative obligations on the parties to disclose the existence of relevant or potentially relevant information in electronic form.” Steven M. Dorvee & Kristin R. Connor, *Electronic Discovery in Technology Litigation*, COMPUTER & INTERNET LAW, Nov. 2003, at 11.

<sup>20</sup> See, e.g., *Janney Montgomery Scott LLC*, No. 3-11604 (SEC Aug. 25, 2004) (settlement of enforcement action in which SEC found that broker-dealer “failed to maintain electronic mail communications”).

<sup>21</sup> William G. Porter, *Between the Devil and the Deep Blue Sea: Monitoring the Electronic Workplace*, DEF. COUNSEL J., Jan. 1, 2003, at 65 (“Litigation is costly in any event. Electronic discovery battles can be even more costly.”).

<sup>22</sup> Also, a cost-saving strategy available in traditional paper discovery—making documents “available for inspection” at the producing party’s premises—may be inadvisable with respect to electronic documents: “it is often unwise to allow an opponent onsite access to one’s file, e-mail, or backup servers because it can be very difficult to separate producible information from that which is irrelevant, confidential, or privileged.” Van Buskirk, *supra* note 17, at T4.

<sup>23</sup> Mary Kay Brown & Paul Weiner, *Ten Ways to Contain the Cost of Electronic Discovery*, PENN. L. WKLY., Sept. 30, 2002, at 8.

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<sup>24</sup> *SEC Strategic Planning: Hearing Before the Subcomm. on Gov't Efficiency and Fin. Mgmt. of the House Gov't Reform Comm.*, 108th Cong. (2003) (statement of Peter Derby, Managing Executive for Operations, SEC) (“[M]utual fund investments now exceed the amount on deposit at commercial banks by more than \$2 trillion and are equal to the approximately \$7 trillion in total financial assets currently in the commercial banking system.”).

<sup>25</sup> *See supra* pp. 3-4 (detailing benefits).

<sup>26</sup> Under this view, providers of legal services “make money by delivering services, not by withholding them,” and they “profit whether or not services have value for recipients.” Charles Silver, *When Should Government Regulate Lawyer-Client Relationships?*, 44 ARIZ. L. REV. 787, 795 (2002). Along these lines, one general counsel observed, “The hourly billing rate is the villain. It is in the best interest of lawyers to do things slowly.” Craig A. McEwen, *Managing Corporate Disputing*, 14 OHIO ST. J. ON DISP. RESOL. 1, 11 (1998) (study of the various ways that corporations manage business-to-business disputes) (quoting unnamed general counsel).

<sup>27</sup> Lawrence A. Salibra, *Proper Management, Not Courts, Can Best Control Litigation*, LEGAL OPINION LETTER (Wash. Legal Found., Wash., D.C.), Jan. 30, 2004.

<sup>28</sup> *Management of Litigation Improves Results and Lowers Costs*, METRO. CORP. COUNSEL, Dec. 2002, at 30 [hereinafter *Management*] (“I was surprised at how little informed price comparison actually takes place. I think that our lawyers took price into account, as I did, in that they had identified price ‘tiers’ among law firms and had expectations as to what firms would charge for various types of work. Through the RFP process, we learned there is a wide range of fees within each ‘tier.’ As a result of the RFPs and our internal dissemination of the results, our in-house lawyers will become more familiar with the firms’ fee proposals and use the same, more cost effective firms, time and time again.”) (quoting Deputy General Counsel of Bank One Corp.).

<sup>29</sup> The average allocations of the firms’ litigation budgets (with and without trial) are reported at Tables 6 and 7.

<sup>30</sup> Brian J. Smith, *Selection of Counsel and Billing Alternatives*, in TRANSPORTATION MEGA CONFERENCE II (A.B.A. 1995).

<sup>31</sup> *Management, supra* note 28, at 30 (quoting Bank One Corp.’s Deputy General Counsel).

<sup>32</sup> *See id.* (“We used requests for proposals (RFPs) to solicit law firms’ interest in handling identified legal work for us for a two-year period.”).

<sup>33</sup> J. Michael Nolan, Jr. & Todd S. Wilson, *Lunchroom Ideas to Improve the RFP Process*, METRO. CORP. COUNSEL, May 2003, at 23.

<sup>34</sup> *See, e.g.*, Stewart, *Client-Lawyer Partnerships Fostering Win-Win Relationships*, in TRANSPORTATION MEGA CONFERENCE II (A.B.A. 1995) (“The standard hourly rate . . . rewards inefficiencies, provides no incentive for superior performance, and places the law firm’s desire to make a profit in direct conflict with the client’s desire to control costs.”).

<sup>35</sup> Typically, in an alternative arrangement, defense counsel shares in the risk of loss. *See* Smith, *supra* note 30 (“[I]n an hourly fee situation, the entire risk of loss, for both costs of defense and loss, lies with the company. Therefore, alternative billing arrangements are intended to share the risk of loss between the company and the law firm.”).

<sup>36</sup> In addition to the forms listed in the text, some variation of the contingency fee is another possibility. Although such arrangements are most often associated with prosecution of a case (as opposed to defense), the concept is in fact adaptable to the defense context. Specifically, in a straight contingency fee arrangement, outside defense counsel would be paid a percentage of the difference between (1) the settlement or judgment amount and (2) the amount of legal exposure estimated in advance by the in-house and outside lawyers. In a mixed fixed/contingent fee arrangement, outside defense counsel would be paid both a fixed fee and also a modest contingent percentage.



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<sup>37</sup> Keith Cunningham, Note, *Father Time: Flexible Work Arrangements and the Law Firm's Failure of the Family*, 53 STAN. L. REV. 967, 1002 (2001); see also Charles Silver, *Flat Fees and Staff Attorneys: Unnecessary Casualties in the Battle over the Law Governing Insurance Defense Lawyers*, 4 CONN. INS. L.J. 205, 221 (1998) (“Flat fees are . . . flexible arrangements that, when handled thoughtfully, offer some important advantages to institutional purchasers of legal services who are dissatisfied with hourly rates.”).

<sup>38</sup> Smith, *supra* note 30 (“In this type of arrangement, the company bears the risk of loss as to the claim itself, while the law firm bears the risk of loss as to the cost of defense. Note that in the fixed fee situation, the entity most capable of evaluating the risk is the entity that bears the risk of loss.”).

<sup>39</sup> Rees Morrison, *Litigation Fee Liposuction*, CORP. COUNSEL, Oct. 2003, at 71 (“If a general counsel can reasonably anticipate his company getting hit with a dozen or more similar cases in the next 18 to 24 months, and if he projects spending more than several hundred thousand dollars on these cases, then he should consider soliciting bids from several firms. For example, American Savings Bank, a thrift formerly based in Irvine, California, bid out its large portfolio of bankruptcy cases. ASB, which has since been acquired by Washington Mutual, Inc., projected that it would save about 15 percent through competitive bidding. The key to the bidding process is that the firm represents the company in the entire batch of cases for a fixed fee.”).

<sup>40</sup> William C. Cobb, *Law Office Management*, 62 TEX. B.J. 670, 671 (1999).

<sup>41</sup> Many insurance companies, including ICI Mutual, have litigation guidelines that may serve as a model for companies wishing to develop their own guidelines for outside counsel. See also the Defense Research Institute’s March 2000 case handling guidelines at [www.thefederation.org](http://www.thefederation.org).

<sup>42</sup> *Litigation Management: Doing More with Less*, METRO. CORP. COUNSEL, Jan. 2004, at 34 [hereinafter *Doing More*].

<sup>43</sup> *Id.* (quoting a Senior Counsel at General Electric Company).

<sup>44</sup> A Jones Day lawyer elaborated this view at a panel (convened by his client) regarding how the client’s legal department could improve: “The most interesting thing was the effort to try to work out who does what and who adds value . . . . The opportunity here is to really isolate and identify the tasks that the outside lawyer can do more efficiently.” Renee Deger, *Chevron Cuts Costs*, LEGAL TIMES, Nov. 17, 2003, at 24 (quoting Jones Day partner Robert Mittelstaedt). “Mittelstaedt said that having in-house lawyers pick up more of the mundane matters allows outside counsel to focus on premium work.” *Id.*

<sup>45</sup> Along these lines, one company created a job description for a “Litigation Management Specialist.” *Id.* (“A committee of [in-house] Chevron lawyers in charge of the overhaul [of Chevron’s legal department] will unveil a plan by the end of the year, says Mark Cervenka, Chevron’s senior counsel in charge of the committee. It will include a new job description for lawyers who will work as *litigation management specialists*, Cervenka says.”) (emphasis added).

<sup>46</sup> *Management*, *supra* note 28, at 30 (“We are involved with preparing witnesses for deposition or trial. Once in a while we will second chair a case.”) (quoting Counsel, Foster Wheeler Corp.); *Doing More*, *supra* note 42, at 34 (“[I]n an effort to cut our outside fees, we are bringing . . . in house . . . a good bit of the discovery in our . . . cases.”) (quoting Chief Counsel, Business & Employment Litigation, International Paper Company).

<sup>47</sup> See Morrison, *supra* note 39, at 71 (“Research, a cash cow at many law firms, can be outsourced to firms that offer quality research at lower costs. . . . Additionally, when a major firm is handling a lawsuit, or a family of lawsuits, that firm can unbundle some tasks in favor of less expensive, local counsel.”).

<sup>48</sup> THOMAS A. MAUET, PRETRIAL 26 (5th ed. 2002).

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<sup>49</sup> See Smith, *supra* note 30 (“The bill for services rendered from outside counsel should be reviewed initially by the in-house attorney. This is not a task to be left to the payables department. The billing practices communicated to the outside counsel should necessarily include itemization of the individual performing the service, the rate charged, the task performed and the time expended.”).

<sup>50</sup> See generally Daniel L. Abrams, *Legal Bill Review in an Era of Subtle Overbilling*, METRO. CORP. COUNSEL, Jan. 2004, at 27 (listing “some relatively common problems that may be uncovered during a bill review”).

<sup>51</sup> See MODEL RULES OF PROF'L CONDUCT R. 1.5(a) (2002) (identifying factors to consider when evaluating reasonableness of legal fees).

<sup>52</sup> Jordan, *supra* note 15, at 58.

<sup>53</sup> See *Management*, *supra* note 28, at 30 (“We are fully implementing electronic billing so that we can slice and dice the information in an invoice, within matters, across matters, across law firms, across practice areas and lines of business, etc.”) (quoting Deputy General Counsel of Bank One Corp.).

<sup>54</sup> See, e.g., *id.* (“Outside counsel need to develop a litigation plan early. Early case evaluation is very important so we can make informed strategic and tactical decisions based on a cost/benefit analysis.”) (quoting a Counsel at Foster Wheeler Corp.); *Doing More*, *supra* note 42, at 34 (“Early case analysis is a key. Where are the areas of strengths and weaknesses in the documents, witnesses and defenses? The tendency is to find the answers as the case goes along. In most cases, it makes sense to try to resolve the dispute quickly. With an early resolution, relationships are less frayed and burdens on management are fewer.”) (quoting the Senior Counsel for Litigation and Legal Affairs at General Electric Co.).

<sup>55</sup> C. Evan Stewart, *The Odd Couple*, N.Y.L.J., Oct. 27, 2003, at 8.

<sup>56</sup> McEwen, *supra* note 26, at 14-15 (“Management of disputing requires establishing clear objectives in dealing with disputes, identifying strategies to achieve those objectives, and monitoring their achievement.”).

<sup>57</sup> *Doing More*, *supra* note 42, at 34 (“Our main philosophy is to do a case assessment as early as possible to decide whether the case should be settled or defended and therefore avoid incurring unnecessary attorneys’ fees.”) (quoting the Chief Counsel, Business & Employment Litigation, at International Paper Company).

<sup>58</sup> Deger, *supra* note 44, at 24 (noting that, in an effort to cut the expenses of its legal department, Chevron “went so far as to open up for external criticism by inviting a panel of eight outside lawyers to dish frank commentary on how Chevron’s 187-lawyer legal department could improve”).

<sup>59</sup> Wilk, *supra* note 15.

<sup>60</sup> Jordan, *supra* note 15, at 57, 60.

<sup>61</sup> Salibra, *supra* note 27. One lawyer interviewed for this Study noted that ADR can end up “eating costs with no advantage created,” and cited a lot of “procedural uncertainties.”

<sup>62</sup> *Doing More*, *supra* note 42, at 34 (quoting the Chief Counsel, Business and Employment Litigation, at International Paper Co.).

<sup>63</sup> See Part I.B.2.d (discovery, and the effect of technology on costs), *supra* p. 11.

<sup>64</sup> Dorvee & Connor, *supra* note 19, at 11.

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<sup>65</sup> Patrick J. Burke & John G. Siegal, *Managing Electronic Records in the E-Discovery Challenge*, N.Y.L.J., Sept. 15, 2003, at T6.

<sup>66</sup> Brown & Weiner, *supra* note 23, at 8.

<sup>67</sup> *Management*, *supra* note 28, at 34 (quoting Vice President & Chief Litigation Counsel, BearingPoint, Inc.).

<sup>68</sup> See *supra* notes 16-23 and accompanying text.

<sup>69</sup> See, e.g., *Medtronic Sofamor Danek, Inc. v. Michelson*, No. 01-2372, 2003 U.S. Dist. LEXIS 8587, at \*10-\*11 (W.D. Tenn. May 13, 2003) (identifying an eight-part “balancing test” that courts have used to decide whether to shift production costs to the requesting party); *In re Bristol-Myers Squibb Secs. Litig.*, 205 F.R.D. 437, 439 (D.N.J. 2002) (discussing the “increasingly common problem of fair allocation of costs associated with discovery in the age of electronic information”); Van Buskirk, *supra* note 17, at T4.

<sup>70</sup> See *Zubulake v. UBS Warburg LLC*, 216 F.R.D. 280, 284 (S.D.N.Y.) (“It is worth emphasizing again that cost-shifting is potentially appropriate only when inaccessible data is sought.”).

<sup>71</sup> Smith, *supra* note 30.

<sup>72</sup> Abigail Johnson, *Decision Has Shaped Trial Practice*, IND. LAW., July 30, 2003, at 9 (“[I]here are no guarantees that the judge will admit the witness as an expert. . . . Who wants to find themselves in the middle of a trial with an expert whose testimony won’t be admitted?”).

<sup>73</sup> Joseph N. Hosteny, *Be Cheap*, INTELL. PROP. TODAY, Aug. 2003, at 18 (“We dealt with a patent law expert, a former PTO employee, whom I won’t name; getting to speak with him, at his rate of \$400 per hour, was like getting an audience with Queen Elizabeth. To make matters worse, he would not prepare. Find a cheaper expert who is willing to dig in.”).

<sup>74</sup> MAUET, *supra* note 48, at 49.

<sup>75</sup> Case law regarding the reasonableness and necessity of an insured’s defense costs is well developed. See, e.g., *Barratt Am., Inc. v. Transcon. Ins. Co.*, 125 Cal. Rptr. 2d 852, 862 (Ct. App. 2002) (holding that insured’s evidence that its costs were “helpful” to its defense “was too theoretical to establish that a reasonable insured would have incurred all of these expenses”); *Employers Ins. v. Recticel Foam Corp.*, 716 N.E.2d 1015, 1027 (Ind. Ct. App. 1999) (holding that insured’s “self-serving opinion” that its defense costs were “reasonable and necessary” was “insufficient” to meet its burden of proof).

## ICI Mutual | *an uncommon value*

### **Aligned Interests:**

owned by, governed by and operated for mutual funds and their advisers, directors and officers

### **Mutual Fund Knowledge and Expertise:**

tailored, innovative coverage combined with expert claims handling

### **Stability and Financial Strength in All Markets:**

consistent coverage and strong capital

ICI Mutual is the predominant provider of D&O/E&O liability insurance and fidelity bonding for the U.S. mutual fund industry. Its insureds represent more than 60% of the industry's managed assets. As the mutual fund industry's captive insurance company, ICI Mutual is owned and operated by and for its insureds. ICI Mutual's services assist insureds to identify and manage risk and defend regulatory enforcement proceedings and civil litigation.

ICI Mutual also serves as a primary source of industry information regarding mutual fund insurance coverage, claims, risk management issues, and litigation developments. Publications include an extensive library of risk management studies addressing such topics as corporate action processing, investment management compliance, computer security, defense cost management, identity theft, and independent direction litigation risk, among others, and the *Investment Management Litigation Notebook*, risk manager alerts, and the annual *Claims Trends* newsletter. Additional services include peer group profiles, coverage analyses, and assistance to insureds and their counsel in litigation defense.



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**ICI Mutual Insurance Company,  
a Risk Retention Group**

1401 H Street NW, Suite 1000  
Washington, DC 20005

800.643.4246  
[info@icimutual.com](mailto:info@icimutual.com)

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