ETHICS CORNER

Fee Awards for In-house Counsel: Just Desserts or Forbidden Fruit?

By Charles D. Tobin

Whether it's after a contentious public records battle, heated copyright litigation, or the obligatory defense against a frivolous claim, nothing brings a smile to a general counsel's lips faster than an award of the company's attorney's fees. The grin turns positively giddy when the lawyer handling the case is in-house. Talk about a win-win. Not only is the substantive issue favorably resolved, but for one brief, shining moment, the legal department is not a cost center – and, depending on the size of the award, it may even bring in a profit.

Do victories like these raise ethical flags? Like most everything else in litigation, the answer depends on who decides the issue, and where it arises. Fee awards to in-house counsel can implicate questions about how much money the company can recover, who can ask for it, and who gets to keep it. Bar ethics rules can quickly wipe the grin off the boss's face.

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The first conundrum for court and corporate counselor is the appropriate measure of the company's success. Courts awarding fees for in-house time have taken two distinct analytical tracks: market value or actual cost. Policy choices – chiefly revolving around how hard the courts should work to decide fee claims and whether companies should financially profit from the use of in-house legal talent – drive the different approaches.

Market-Based Award

Market-based awards follow the "lodestar" method. That is, the court calculates the prevailing corporation's lawyer's fee according to the reasonable number of hours actually devoted to the case multiplied by the prevailing hourly rate in the community for similar work. The court may also take into account additional factors,

> "including the nature of the litigation, its difficulty, the amount involved, the skill required in its handling, the skill employed, the attention given, the success or failure, and other circumstances in the case."

PLCM Group, Inc. v. Drexler, 22 Cal. 4th 1084 (Cal. 2000) (citation and internal quote marks omitted).

In *Drexler*, a contract action, California's Supreme Court found the market-based award less "cumbersome, intrusive, and costly to apply" than the burden of requiring corporate litigants to disclose attorney compensation figures and tabulate the precise allocation of overhead for their in-house counsel. *Id.*, 22 Cal. 4th at 1098. *But see*, *Broadcast Music, Inc. v. R. Bar of Manhattan, Inc.,* 919 F. Supp. 656 (S.D.N.Y. 1996) (federal court employs market-rate analysis in copyright action, but reduces in-house fee award by 50% because lawyer did not keep contemporaneous time records and could only furnish an estimate through "hindsight review").

Cost-Plus

Other courts have taken a different view, adhering to the "cost-plus" approach. Under this method, the in-house lawyer's fee is calculated based on her actual total compensation — including salary and benefits — and the proportionate share of her overhead. Utah's Supreme Court, among others, has found the cost-plus method to be "the more reasonable measure of attorney fees to in-house counsel." The quote below is from *Softsolutions Inc. v. Brigham Young University*, 1 P.3d 1095, 1107 (citation omitted):

> "Fees for in-house counsel are limited to consideration actually paid or for which the party is obligated, calculated using a cost-plus rate and taking into account (1) the proportionate share of the party's attorney salaries, including benefits, which are allocable to the case based upon the time ex-

(Continued on page 52)

Fee Awards for In-house Counsel: Just Desserts or Forbidden Fruit?

(Continued from page 51)

> pended, plus (2) allocated shares of the overhead expenses, which may include the costs of office space, support staff, office equipment and supplies, law library and continuing legal education, and similar expenses. The party seeking recovery of fees has the burden of proving these amounts."

The court also was of the view that, while it should render a prevailing corporate litigant whole cases where fees are recoverable, the company should not make money off of its decision to use in-house legal talent.

> "[T]he basic purpose of attorney fees is to indemnify the prevailing party and not to punish the losing party by allowing the winner a windfall profit."

Softsolutions, Inc. v. Brigham Young University, 1 P. 3d 1097, 1107 (Utah 2000).

Fairness or Fee Splitting

Not surprisingly, the corporate counsel community favors the market-based approach. The court in *Drexler* largely followed the reasoning of a brief *amicus curaie* submitted on behalf of the American Corporate Counsel Association (ACCA). In addition to advancing arguments that a market-based fee is easier to calculate and results in a more reasonable fee, ACCA's brief also suggested that the cost-plus method relegates corporate counsel to second-class citizenship of sorts, as it would "mandate a separate (and non-equal) standard for in-house counsel" by subjecting their fee calculations "to desultory, highly-detailed, and intrusive scrutiny."

Some authorities, however, have raised concerns that run deeper than issues of intrusiveness, certainty, and fairness. Under their reasoning, market-based recovery for a corporation's lawyer's time amounts to fee-splitting with nonlawyers. For example, the Sixth Circuit rejected the market approach urged by the successful defendant in a patent-infringement action. In *PPG Industries, Inc. v. Celanese Polymer Industries, Inc.*, 840 F.2d 1565, 1570 (6th Cir. 1988), the court of appeals held that on remand, the district court should consider a cost-based calculation, in part because the market system struck the panel as ethically suspect:

> "The implication of using a private firm market standard is to allow a nonlegal business corporation to use the services of in-house counsel, and reap a profit therefrom. We know of no authority to support this practice."

Indeed, the Sixth Circuit's observation raises a critical and thorny ethical question. If a corporation recovers more than the market rate for the employee-litigator's efforts, does the company engage in the unlicensed practice of law by earning income for legal representation by an employee? That is the view the ABA has taken in opining that it is simply unethical for a corporate employer to recoup more than its in-house lawyer's direct costs.

ABA Approach

ABA Formal Op. 95-392 (Apr. 24, 1995), titled "Sharing Legal Fees with a For- Profit Corporate Employer," notes that Rule 5.4, ABA Model Rules of Professional Conduct flatly prohibits a lawyer from sharing legal fees with a nonlawyer. Moreover, the opinion observes, Rule 5.4(c) provides that lawyers cannot let someone who is paying the legal bills for another person "direct or regulate the lawyer's professional judgment[.]"

The opinion finds it untenable for a company to create "a situation in which the provision of legal services by the in-house lawyers became a profit center for the enterprise." The pressures to pursue the highest profit, the opinion suggests, would cloud the in-house litgator's sound legal judgment: under a market-fee system, they wrote, "the corporation's incentive to interfere with its lawyers' handling of matters would be enhanced." ABA Formal Op. 95-392 at 4-5. The ABA opinion concludes that "a for-profit corporation should not share in court-awarded attorney's fees with respect to services provided by its lawyer employees," except for recovery of "the corporation's cost of providing the legal services in question." Id. at 5-6.

Years earlier, the Circuit Court of Appeals for the District of Columbia found similar cause for pause when an attorney, who represented a plaintiff under a union's prepaid legal services plan, candidly disclosed at oral argu-

(Continued on page 53)

Fee Awards for In-house Counsel: Just Desserts or Forbidden Fruit?

(Continued from page 52)

ment that the union would bank any fee award. *National Treasury Employees Union v. U.S. Dept. of Treasury*, 656 F. 2d 848 (D.C.Cir. 1981). Looking to the ABA canons for guidance, the court found that the disclosure rendered untenable any argument for a market-based fee award.

> [This] means that the employing lay organization would capitalize on the attorney's services, reap a profit therefrom, and put the monies thus made to any use it chooses. In the absence of any compelling reason to disregard the ethical considerations implicated and we discern none here we believe that an allowance of above-cost fees to the union is inappropriate.

Id. at 853. *See also Harper v. Better Business Services, Inc.*, 768 F.Supp. 817 (N.D.Ga.,1991) (in action where counsel retained under union prepaid legal services plan, court rejects market approach and awards fees based on actual cost, citing Georgia Code of Professional Responsibility.)

Let the Lawyer Keep It

Of course, there is a simple and obvious solution to any ethical issues for corporations that want to recover a market-rate award for use of in-house talent. In fact, the D.C. Circuit hinted at it in *National Treasury Employees' Union.* And the ABA Committee on Ethics and Professional Responsibility drew a roadmap for the corporate counselor preparing her fee petition:

> It is permissible for the corporation to be reimbursed for its costs, and its lawyer can receive directly fees in excess of the corporation's cost, but it is unethical for the lawyer to share the excess with the corporation.

ABA Formal Op. 95-392. In other words, the court awards the market rate, the corporation keeps its actual costs, and *the in-house lawyer keeps the profit*.

The general counsel may not grin at that advice. But others in the legal department surely will.