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Cover Page Footnote

None.

AN EXECUTIVE'S LESSON IN THE LAW FROM A TYPICAL BUSINESS ENCOUNTER

*Harold A. Segall**

Introduction

This is the first article in a series prompted by the difficulties that businesspeople in the United States face when operating within the framework of an unsatisfactory civil legal system. A hypothetical situation relating to the collection of a delinquent account receivable is employed to demonstrate the recommendation that executives should consider potential legal problems when entering into business transactions.

Part I of this article provides examples of the perils of litigation and explains that business executives can try to avoid these perils by anticipating potential legal problems. As an illustration, Part II outlines a particular delinquent account receivable problem and lists the questions a business executive is likely to ask a lawyer when choosing between settlement and litigation. Part III sets out the likely answers to these questions and reviews the issues to be addressed in a settlement agreement. This article concludes that the delinquent account receivable problem, like a number of other business-legal problems, can be averted or mitigated if the executive anticipates the difficulty and takes the indicated precautions.

I. The Unsatisfactory State of the Civil Legal System

The practice of law over fifty years has demonstrated to me that the successful business executive finds a way to balance his optimistic, entrepreneurial spirit with a lawyerlike way of considering potential future problems. Similarly, experience shows that the proper role of a commercial lawyer, as part of the management team, is to provide judgment and practical advice, as well as legal expertise.¹ A good commercial lawyer focuses not on

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1. The author has conducted a seminar at the Yale Law School in contract drafting and subsequently in each of three consecutive years devoted one day a week to giving a course, "Legal Aspects of Managerial Decision-Making," at the Yale School of Organization and Management. The author has also given seminars to law firms and has written articles for *THE PRACTICAL LAWYER* and other publications.

a legal problem *per se*, but on the legal aspects of a business problem.²

When a lawyer is consulted in connection with a contemplated transaction, it is pointless to attempt to identify which aspects call for commercial attention and which call for legal attention. A lease, the purchase and sale of a business, an agreement with a salesman or distributor or for the purchase and sale of goods, and many other transactions present intertwining commercial and legal considerations. The client and lawyer should work together as a team on the assignment.³ Although the executive must make the decision, both the client and the lawyer should focus on the same question in many vital areas. Usually the client is not well advised simply to turn over the negotiations and paper work to his or her lawyer. The client should stay involved just the way he or she does with an architect.⁴ If a new plant is to be designed and built, the owner or executive should take the architect through the existing plant and express his or her views as to its desirable features and the features that can be improved for efficiency or economy or to provide for the contemplated production capacity. The executive should also stay involved during all stages—the concept and preliminary plans, the final specifications, the letting of bids and the construction. The same methodology should prevail in the lawyer-client relationship, the degree of client involvement depending, of course, on the nature and importance of the assignment.

Businessmen thinking like lawyers must consider that a court action in this country typically is costly, slow and risky.⁵ The out-

2. If a lawyer for the first time in his career receives the assignment of negotiating a share-the-profits lease with a hotel chain on behalf of a client who will erect and own the hotel, the lawyer would be well advised to read a book on hotel accounting and to examine several leases covering similar arrangements, not only for his legal education but also to gain an understanding of the commercial give and take between the owner of the hotel and the operator, for example, over which party is to provide the various inventories to be used in the hotel.

3. Joel F. Henning, *A Legal Department Can Reorganize For Quality*, 636 PLU COMM. 55 (1992) (“What’s important in a [total quality culture environment] is to insure that lawyers work with clients as a team to make sure that the right questions are asked.”).

4. Whitney Gould, *Architecture a “Gentleman’s Club,”* STAR TRIB., Jan. 21, 1996, at 11E (quoting architecture professor Kathryn Anthony’s assertion that architecture schools should teach “‘co-creativity’ . . . in reflection of the collaboration that’s essential between architects and clients”); Jane Adler, *By Design; Bradford Elected President of Chicago Architects’ Chapter; Touts Teamwork*, CHI. TRIB., July 9, 1995, at C3 (quoting William Bradford’s assertion that “[c]lients and architects need to work in greater collaboration in the sense that all projects involve teams”).

5. Thomas Masterson, *ADR Has Evolved From Time Immemorial*, PENN. LAW WEEKLY, Nov. 13, 1995, at S2 (“CPR [National Panel of Distinguished Neutrals] con-

come of a good portion of civil cases is as unpredictable as a game of chance.⁶

Juries return verdicts that defy common sense and award staggering damages.⁷ A 1991 nationwide poll of people eligible for jury duty found that 70% were more likely to favor an individual plaintiff over a corporate defendant before they knew anything at all about the dispute.⁸ A key finding was that 60% of jurors deemed a judgment for a million dollars "just a slap on the hand" for a corporation, even though most understood that many jury verdicts are too large.⁹

Punitive damages are imposed in routine cases with increasing frequency.¹⁰ For example, in 1993, an Alabama jury found that Delta Woodside Industries had wrongfully denied a salesman and two associates \$852,118.00 in sales commissions.¹¹ The jury returned a \$29.1 million verdict, which broke down as follows: \$2.6 million for breach of contract; \$7 million for mental anguish; and \$19.5 million in punitive damages.¹²

cluded that civil litigation was too slow and too costly . . ."); Bradford W. Hildebrandt, *Planning Your Firm's Long-Term Future*, THE CONN. LAW TRIB., July 19, 1993, at 23 ("The litigation process is too slow and costly for most clients.").

6. A federal judge in Brooklyn, in commenting on verdicts of \$31 million in a batch of asbestos lawsuits, said the results take on the "aspects of a lottery." Daniel Wise, *Verdicts of \$31 Million in Asbestos Lawsuits; Weinstein Terms Process of Handling Claims "A National Scandal,"* N.Y. L.J., Jan. 25, 1991 at 1.

7. See, e.g., Calvin Sims, *\$9 Million Won For Loss of Arm in Drunken Fall*, N.Y. TIMES, Sept. 21, 1990, at B3 ("A dishwasher who fell onto a subway track and was hit by a train has been awarded \$9.3 million in damages even though he was drunk at the time of the accident."). However, the New York Appellate Division, First Department, recently reversed and dismissed the complaint on the basis that plaintiff had failed to prove both the breach of the duty of due care and proximate cause. See N.Y. L.J., Mar. 7, 1996, at 25 (*Francisco Merino v. New York City Transp. Auth.*).

8. Stephen J. Adler, *Legal Beat*, WALL ST. J., Nov. 13, 1991, at B5. The poll was conducted by Metricus, a California-based research firm. *Id.*

9. *Id.*

10. Bruce Hight, *Punitive Awards: Burden on Economy*, AUSTIN-AM. STATESMAN, Apr. 6, 1994, at E1 ("A striking increase in the frequency and amount of punitive damages awarded . . . has created a burden on the Texas economy that is 'heavy, pervasive and increasing,' according to a study by the Texas Public Policy Foundation."); Editorial, *Dollars and Damages*, WASH. POST, Jan. 30, 1987, at A20 ("[P]unitive damage awards are increasing in frequency and in dollar amount, especially when the defendant is a business or a corporation."); but see Bruce Hight & Mary Coppinger, *Questioning Tort Reform*, AUSTIN-AM. STATESMAN, Jan. 8, 1995, at J1 ("There is no conclusive evidence . . . of juries assessing excessive punitive damage awards or that the number of such judgments is increasing, according to a study by the American Bar Foundation . . .").

11. *Delta Woodside Hit With \$29.1 Million Verdict in Alabama*, BLOOMBERG BUS. NEWS, Nov. 27, 1993, at 5.

12. *Id.*

In a separate case, a female executive who was dismissed by the Olsten Corporation was awarded \$5.18 million in damages by a federal jury that found the company discriminated against women.¹³ The plaintiff's salary at the time her employment terminated was \$84,000 a year.¹⁴ The award included \$150,714 in back wages, about \$29,400 for pain and suffering and other losses, and \$5 million in punitive damages.¹⁵

In another case, a \$104,000-a-year construction executive was awarded \$5.1 million in damages on a claim that he had been unfairly pushed out of his job.¹⁶ The award included \$2 million for "emotional distress" and \$1 million in punitive damages.¹⁷ Litigating such cases takes on the character of entering a lottery.¹⁸

Consequently, alternate dispute resolution is generally a better path to take than litigation.¹⁹ Nonetheless, alternate dispute resolution is a consensual arrangement and therefore unavailable in the absence of agreement by all parties. Even when agreement occurs, alternate dispute resolution is like survival strategy after a shipwreck.

In order to avoid the triage involved in both alternative dispute resolution and litigation, top-notch executives should develop an-

13. *Luciano v. The Olsten Corp.*, — F. Supp. —, 1996 U.S. Dist. LEXIS 613 (E.D.N.Y. Jan. 21, 1996).

14. *Associated Press, Jury Awards Woman \$5 Million in Lawsuit Alleging "Glass Ceiling,"* CHI. TRIB., Nov. 12, 1995, at C12.

15. *Luciano v. The Olsten Corp.*, — F. Supp. —, 1996 U.S. Dist. LEXIS 613 (E.D.N.Y. Jan. 21, 1996).

16. *Hunio v. Tishman Constr. Corp.*, 14 Cal. App. 4th 1010, 18 Cal. Rptr.2d 253 (2d Dist.), *rev. granted*, 854 P.2d 79 (Cal. 1993), *transferred back*, 882 P.2d 248 (Cal. 1994) (ordering vacation of judgment not on the basis of a damages issue); Theodore J. Boutrous, Jr., *Rule of Lost Your Job? Sue and Make a Million*, WALL ST. J., July 28, 1993, at A15.

17. *Hunio v. Tishman Constr. Corp.*, 14 Cal. App. 4th 1010, 18 Cal. Rptr.2d 253 (2d Dist.), *rev. granted*, 854 P.2d 79 (Cal. 1993), *transferred back*, 882 P.2d 248 (Cal. 1994) (ordering vacation of judgment not on the basis of a damages issue).

18. *Texaco Inc. v. Pennzoil Co.*, 626 F. Supp. 250 (S.D.N.Y.), *modified and remanded*, 784 F.2d 1133 (2d Cir. 1986), illustrates the hazards of defending a lawsuit in the United States. In November 1985, a Houston jury awarded Pennzoil \$10.53 billion on its complaint against Texaco. The gravamen of the complaint was the accusation that Texaco had induced Getty Oil to breach an "agreement in principle" for Pennzoil to purchase almost 43% of Getty common stock for \$2.6 billion. A scholarly analysis of the issues reveals that the award was remarkably erroneous. The management of Pennzoil must have agreed with this assessment of the weakness of its case because Pennzoil retained Joseph Jamail on a contingent fee basis. If Pennzoil at the outset had confidence in its own case, it would have paid its lawyers on an hourly fee basis. Legal fees on an hourly basis would have aggregated at most a few million dollars. In contrast, Jamail is said to have received \$600 million following a settlement for \$3 billion.

19. *See Masterson*, *supra* note 5, at S2.

tennae which pick up legal problem warning signals. They should understand how legal problems arise, how to spot them, how to cope with them, how to avoid or minimize legal complexities where possible, how to work with and manage lawyers and how to keep legal costs down without sacrificing, and while even improving, legal protection.

II. The Delinquent Account Receivable Problem

The following hypothetical explores the issues that business executives must keep in mind if they are to avoid or mitigate the problem of a delinquent account receivable. It also illustrates how unsatisfactory recourse to the law can be when executives fail to anticipate legal problems.

In this hypothetical, Smith Enterprises Inc. (SEI, or, informally, Smith), a manufacturing concern that has been in business only a few years, but appears to be successful and is growing, received a verbal order from Bruce Brothers Corporation (Buyer, or Bruce Brothers) owned by Thomas and George Bruce. The order is for \$250,000 worth of goods to be manufactured to the Buyer's specifications. The goods were shipped and, although the Buyer was obligated to make payment twenty days after invoice, eight months have passed without receipt of payment.

Throughout the eight months, William Smith (Smith), the owner of SEI, made telephone calls to the Bruce brothers to ask about payment. The Bruce brothers would consistently respond that they were planning to pay as soon as funds became available, but they also made a point of saying that there was some defect in the goods. Smith assumed that the talk about a defect in the goods was just a red herring.

After eight months without payment, Smith has a conversation with the Bruce brothers that makes him irate. Once again the Bruce brothers tell Smith that the goods were defective; this time, however, they go on to say that because they "want to be fair," they are willing to pay Smith \$225,000 in full settlement for the \$250,000 invoice, with the \$225,000 to be paid at the rate of \$25,000 per month for nine months at 6% interest from the date a settlement agreement is signed. Smith concluded the conversation by telling off both Bruce brothers. He then immediately telephones his lawyer, Albert Dunn (Dunn), and summarizes the situation, explaining that he wants legal action and that he wants it fast.

As it turns out, Smith needs the \$250,000 for working capital. He is borrowing money from his bank at 1% over the prime rate (which currently is 8.75%) and there is a limit on his line of credit.

Smith has a number of objectives in mind. The most important will be for Dunn to get the \$250,000 for SEI immediately, especially in view of the fact that the debt is more than eight months overdue. Additionally, Smith will want the court to order that the Buyer reimburse SEI for legal fees paid to Dunn and pay interest at the same rate which Smith pays on his bank loan. Finally, Smith will want the Buyer to pay treble damages in view of the outrageous and deceptive conduct on the part of Thomas and George Bruce.

Accordingly, Smith will present the following questions to his lawyer, Dunn:

Question No. 1: How long will it take Smith, through court action, to get the money owed to him by Bruce Brothers?

Question No. 2: Will Bruce Brothers be ordered by the court to pay the legal fees incurred by Smith?

Question No. 3: How does Dunn charge and what will the total legal fee be?

Question No. 4: Is Dunn willing to take the case on a contingent-fee basis?

Question No. 5: Will a judgment against Bruce Brothers carry the same rate of interest that Smith pays to his bank?

Question No. 6: Can Smith get treble damages in the suit he is contemplating against Bruce Brothers?

Question No. 7 (the bottom line question): What should Smith's decision be in response to the outrageous offer made by Bruce Brothers?

III. The Answers

1. *How long will it take Smith, through court action, to get the money owed to him by Bruce Brothers?*

Let's face it, nothing much has changed since Shakespeare's day. Hamlet lists the "law's delay" as one of the ordeals mankind has to endure.²⁰ Delay in adjudication is as certain today.²¹

20. WILLIAM SHAKESPEARE, *HAMLET*, act III, sc. 1, line 72 (T.J.B. Spencer ed., Penguin Books 1980); see also, *Evans v. Philadelphia Transp. Co.*, 212 A.2d 440, 455 (Penn. 1965) (Musmanno, J., dissenting) ("If Hamlet lamented over the 'law's delays' [sic] in 1602, I should like to hear him on the snail's gallop of the law in 1965 . . .").

21. See Robert G. Bone, *Mapping the Boundaries of a Dispute: Conceptions of Ideal Lawsuit Structure From the Field Code to the Federal Rules*, 89 COLUM. L. REV. 1, 3 (1989) ("Jurists today complain about the excessive cost and the unreasonable

Business executives often mistakenly believe they are asking a lawyer a simple question when they inquire how long a lawsuit will take. Most of the time a lawyer does not know the answer to a reasonable probability.²² The length of a lawsuit will depend upon the nature of the claim, whether, under the law governing the case, there is a right to a trial by jury, whether the case is brought in a Federal or State court, and if in State court, in which State and in which part of the State. The time that it will take to reach trial will also depend on the ability of the judge and his willingness to work and the ability and attitude of the lawyers for the respective parties.

Experience shows that federal and state judges consistently tolerate dilatory tactics, despite modern civil procedure rules intended to inhibit actions taken in bad faith.²³

The discovery process, for example, has been largely distorted. It was intended to prevent surprise and give each side the advantage of full preparation, but it is often abused to cause needless delay and expense.²⁴

delay of litigation, the result, they argue, of an overburdened court system and overzealous advocacy.”); *see also*, Bill Bloomfield, *Civil Lawsuit Reform, Searches*, L.A. TIMES, Nov. 1, 1995, at B8 (“This plague of lawsuit abuse is choking the court system in California, causing outrageous delays on those cases which have merit but unfortunately cannot be heard in an appropriate period of time.”); Mary Beth Murphy, *Judge Defies Law On Counsel for Poor Parents*, MILWAUKEE J. SENT., Oct. 13, 1995, at 3 (noting costly delays in Milwaukee’s juvenile court system); Kevin Davis, *In Loving Hands; Woman Devoted to Caring for the Child of Her Slain Daughter*, SUN-SENTINEL, Jan. 31, 1995, at 1A (noting delays in criminal court system).

22. *See, e.g.*, Junda Woo, *Couple Wonder If They Will See End to Lawsuit Filed 15 Years Ago*, WALL ST. J., Mar. 24, 1994, at B5.

My own law firm represented a group of prominent investors in litigation against the principals of the defunct Home-Stake Production Co., which had engaged in large tax-shelter promotions. Other law firms represented other investors. A November 20, 1989 Wall Street Journal article reported the entry of judgment in the sixteen-year-old case. Admittedly, the case had very complicated issues, involving class certification, the liability of the lawyers who drafted the prospectus, the liability of the accounting firm, multi-district problems and the extent of the exposure of the insurance company which, although putting a relatively small cap on the exposure for any one claim, made the mistake of not imposing a total cap for claims in the aggregate. Even the entry of judgment did not mark the end of the legal proceedings. Settlement of claims against the company was complicated by its bankruptcy proceedings. The Supreme Court of the United States has twice considered various issues in the case and now, six years after the entry of judgment, there are still unsettled issues relating to non-settling defendants, stemming from a change in the case law, as well as new legislation.

23. *See, e.g.*, FED. R. CIV. P. 11.

24. *See generally*, Study No. 874017 conducted by Louis Harris & Assoc., Inc. for Aetna Life & Casualty, *Issues in Civil Procedure: Advancing the Dialogue A Symposium: Judges’ Opinions on Procedural Issues: A Survey of State and Federal Trial*

Similarly, although the rules of civil procedure make available an expedited summary judgment in clear-cut cases, the granting of summary judgment is rare even when warranted.²⁵

The reasons why judges tolerate delay and deny summary judgment are manifold. Some judges are merely lazy. They shirk the task of reading the motion papers carefully enough to resolve the legal issues. Instead, they dismiss the application for summary judgment with the time-worn phrase, "Triable issues of fact exist."

Some judges treat summary judgment as an infringement of a basic civil liberty. They see summary judgment as an interference with the sacred role of juries,²⁶ despite the fact that for hundreds of years in commercial cases directed verdicts and judgments notwithstanding the jury verdict have been a part of the Anglo-Saxon legal tradition.²⁷

The harm that results from denying a meritorious motion for summary judgment is often significant to the outcome of a case. The denial of summary judgment drastically alters the negotiating

Judges Who Spend at Least Half Their Time on General Civil Cases, 69 B.U.L. REV. 731, 733 (1989) ("Both state and federal judges believe that abuse of the discovery process is the most important cause of delays in litigation and of excessive costs.").

25. See *Andre v. Pomeroy*, 320 N.E.2d 853, 855 (N.Y. 1974) ("[A]s a practical matter summary judgment continues to be a rare event in negligence cases."); *Illinois v. Brumfield*, 390 N.E.2d 589, 594 (App. Ct. 5th Dist. 1979) ("Summary judgments are allowed on rare occasions in civil cases, but never in criminal cases."); see also, Michael C. Silberberg, *Southern District Civil Practice Roundup*, N.Y. L.J., Nov. 3, 1994, at 3 (discussing refusal of Southern District of New York Judge Gerard L. Goettel to grant summary judgment in employment discrimination case on the grounds that the Second Circuit had "all but outlawed" the use of summary judgment in such actions).

26. See *Hardin v. Pitney-Bowes, Inc.*, 451 U.S. 1008 (1981) (Rehnquist, J., dissenting from denial of certiorari) ("[I]t is inappropriate to resolve issues of credibility, motive and intent on motions for summary judgment."); Lee Levine, *In Memoriam: Mark Kinloch Wilson: Article: Judge and Jury in the Law of Defamation: Putting the Horse Behind the Cart*, 35 AM. U.L. REV. 3, 53 (1985) ("The apparent conflict between the concept of summary judgment and the role of the jury in assessing witness credibility has received the most detailed judicial attention in the context of antitrust litigation . . .").

27. William W. Schwarzer, et. al., *The Analysis and Decision of Summary Judgment Motions*, 139 F.R.D. 441, 446 (1992) (noting that summary judgment practice was inherited from English law). The propriety of setting aside a clearly erroneous jury verdict in an employment discrimination case is illustrated by the decision in *Flynn v. Goldman, Sachs & Co.*, 836 F. Supp. 152 (S.D.N.Y. 1993) (Wood, J.). The court found that " 'there is such a complete absence of evidence supporting the verdict that the jury's finding could only have been the result of sheer surmise and conjecture.' " *Id.* at 164.

position of the parties and the dollar figure in settlement talks.²⁸ The party who should have been granted summary judgment must now calculate the legal costs in preparing for and conducting a full-blown trial, the loss of executive time in connection with the lawsuit and the risk of an unfavorable verdict from unpredictable jurors.²⁹

For the purpose of our exercise, let's assume that we are dealing with a time-frame of at least three years for a lawsuit by Smith against Bruce Brothers even if there is no appeal to a higher court after the conclusion of the trial.³⁰

2. *Will Bruce Brothers be ordered by the court to pay the legal fees incurred by Smith?*

The answer is "No." If Smith wins, he will be entitled to relatively minor "court costs" such as filing fees, but unless there is a special statute that governs this particular kind of case or legislative reform is accomplished, he will have to pay his own attorney fees.³¹

Obviously, the fees of the attorney for Smith can be quite substantial in relation to the matter in controversy,³² especially if after

28. See generally, Samuel Issacharoff & George Lowenstein, *Second Thoughts About Summary Judgment*, 100 YALE L.J. 73 (1990). (analyzing the effect of summary judgment on settlement negotiations).

29. To cite one of many such experiences, our firm brought a motion for summary judgment in an antitrust suit instituted against our client in the field of radio communications equipment. Summary judgment for the defendant was granted on the plaintiff's count of monopoly but was denied on the count of attempt to monopolize. At the conclusion of the ensuing trial, the jury found for the plaintiff but the judge properly granted judgment notwithstanding the verdict. The victory was welcome but substantial legal expense to our client was entailed in the preparation and conduct of the trial and valuable executive time was lost.

30. Jury cases in urban centers average five years before trial is reached. RAND CORPORATION INSTITUTE FOR CIVIL JUSTICE, ANNUAL REPORT 1991-2 (1992).

31. Contrary to the rule in most major legal systems, American law provides that the winning party must pay its own legal fees, unless a special statute applies to the subject matter of the litigation. The American rule was first articulated by the U.S. Supreme Court in *Arcambel v. Wiseman*, 3 U.S. (3 Dall.) 306 (1796); see generally, WALTER K. OLSON, *THE LITIGATION EXPLOSION* 329-30 (1991) (discussing fee shifting practices in European countries); L. Gordon Crovitz, *Rule of The More Lawsuits the Better and Other American Notions*, WALL ST. J., Apr. 17, 1991, at A15.

32. A number of illustrations of how substantial legal fees mount up in defending a plainly unmeritorious case have arisen in my practice. In one case, a claim was made against a client of ours for human rights discrimination. Complaints were filed successively before the Human Rights Commission, the EEOC and in a civil suit in which the plaintiff appeared *pro se*. The federal judge leaned over backwards in favor of the plaintiff in the conduct of the court proceedings, although he eventually dismissed the claim in no uncertain terms. Under the law, the plaintiff had several bites

suit has been filed, there is an eventual settlement for considerably less than the amount that was owed.

3. *How does Dunn charge and what will the total legal fee be?*

Since Smith has been told that even if he wins the lawsuit Bruce Brothers will not be required to pay the legal fees incurred by Smith, he now proceeds to ask how much it will cost him in legal fees if he sues Bruce Brothers.

The lawyer not unexpectedly tells Smith that he cannot come up with a figure because the time a lawyer will spend in litigation will vary considerably, depending upon whether settlement is worked out before trial, whether the lawyer will have to make preliminary court motions or cope with motions brought by the other side, whether or not Bruce Brothers will assert a counterclaim, the amount of time consumed in depositions and in other forms of discovery, etc.

Since the total fee cannot be estimated, the next inquiry will be the hourly rate charged by Dunn. Hourly rate billing is now common for lawyers handling complex commercial matters. But the business executive usually finds the amount charged to be astonishing and the lawyer himself often does a double-take when he looks at his bookkeeper's tabulation of time charges.³³

4. *Is Dunn willing to take the case on a contingency fee basis?*

In view of Dunn's hourly rate and the uncertainty as to the amount of legal time that the case may take, a good question for Smith to pose is whether Dunn would be willing to handle the case on a contingency fee basis. From Smith's point of view such an arrangement would have two advantages as against the possibility or even likelihood that he would end up paying a higher fee than if he paid Dunn on an hourly basis: first, if the suit should be lost or

of the apple. The fact that the Human Rights Commission had found against the plaintiff did not forestall or end the complaint before another tribunal. In fact, a complaint had also been made to the New York State Attorney General and the last turn of the screw was an inquiry by the United States Department of Labor which insisted that it had to make its own determination despite the fact that plaintiff's claim was found baseless in all of the prior proceedings.

33. Consequently, businesses are imposing restraints on the hourly billing system. Steve Hirsch, *Is There a Lawyer in the House?; Study Targets Midsize Firms*, THE RECORD, Oct. 22, 1995, at B1 ("Perhaps the most radical change in the legal marketplace has been clients [sic] willingness to challenge the traditional hourly billing system that most law firms employ."); Weaver H. Gaines, *Legal Services as Products*, THE CONN. LAW TRIB., May 22, 1995, at 8 (1995) ("Increasingly, clients are demanding that lawyers bid for business based on a fixed price.").

settled for a low amount, Smith will save money by the arrangement, and second, Smith, except for disbursements for costs, will not be out-of-pocket any further until he collects on the judgment against Bruce Brothers.

Although Dunn desires to please Smith, his answer as to whether he would take the case on a contingency fee basis probably will be "No." Lawyers with expertise in commercial cases generally believe that it is undesirable to conduct a commercial case on a contingency fee basis. This point is illustrated by the Vendo-Stoner case that took 17 years to resolve.³⁴ Although the suit was ultimately successful, the final settlement did not provide appropriate compensation for Vendo's lawyer. He represented the plaintiff on a contingency fee basis and over the years had been paid only out-of-pocket expenses. When the settlement was agreed to, Vendo's lawyer stated: "If you look back over all these years, and you analyze the hourly rates, you find it's less than the rates I used to get as a caddie."³⁵

As Smith pauses to digest the unwelcome input he has received in response to his questions, Dunn has a question of his own that he has been waiting to ask: how vulnerable is Smith to a counterclaim for a defect in the goods.

After Smith responds with some details and voices his conclusion that there is very little merit to the contention that the goods were defective, Dunn points out (for future guidance and not to rub salt in Smith's wounds) that a written sales contract can protect a seller by setting a short period within which any claim for a defect must be made, and more importantly, can limit the seller's potential lia-

34. Erik Larson, *Flash: California Suit Has Finale—17 Years After It Was Brought*, WALL ST. J., Jan. 7, 1983, at 15.

35. *Id.* Of course personal injury lawyers almost invariably work on a contingent fee basis and want it that way, usually for their own benefit, especially when liability on the part of the defendant appears to be clear and the recovery is likely to be large. See also Crovitz, *supra* note 31, at A15.

Our firm represented a plaintiff on a contingency fee basis in an antitrust action after the U.S. Department of Justice had found an antitrust violation in the syndication of comic strips. Although the case looked like a surefire winner, it turned into a long, drawn-out affair. The relevant events had taken place a number of years before the institution of suit and, therefore, it was necessary to develop the case through subpoenas for deposition testimony of non-party witnesses located in various south-eastern states. Furthermore, the wealthy defendants contested everything from jurisdiction and venue to virtually every aspect of the discovery process, consuming an inordinate amount of legal resources. Although a reasonable settlement was eventually arrived at, it taught us to leave the contingency fee cases to the personal injury practitioners, even though on occasion contingency fee cases are more lucrative.

bility for damages in a number of significant ways.³⁶ After discussion, Smith and Dunn agree that although the odds are high that Bruce Brothers cannot make a counterclaim stick, if the counterclaim were to be successful, the damages that might be awarded on the counterclaim could be higher than the amount due Smith on the invoice.

5. *Will a judgment against Bruce Brothers carry the same rate of interest that Smith pays to his bank?*

Again the answer will not be to Smith's liking. Dunn will explain that state law fixes the interest rate on a contract claim³⁷ and that most of the time, at least when interest rates are high, the rate of interest that is payable on the judgment amount may well be below the prevailing interest rate. Assume that Smith currently borrows at one point above the prime rate, the prime rate being set hypothetically at 8.75%.

Smith was supposed to have been paid twenty days after shipment. Eight months have passed and if Smith proceeds with litigation it will take at least three more years before Smith can secure and collect a judgment. The judgment will carry interest from the date twenty days after the shipment of the goods, but if Smith decides to prosecute the lawsuit, he probably will lose the interest differential for at least three years.

6. *Can Smith get treble damages in the suit he is contemplating against Bruce Brothers?*

Smith feels that he has been chiselled by a pro. He is irate. The answer to the question as to his right to treble damages will do nothing to improve his mood. Although there is a growing (and unfortunate) practice nowadays on the part of judges to permit juries to tack on punitive damages in a routine tort claim, punitive damages generally are not awarded in debt collection suits like this one.³⁸ Despite Smith's indignation at the conduct of the Bruce brothers, there was no ostensible fraud on their part. The case ba-

36. See U.C.C. § 1-102(3) ("The effect of provisions of this Act may be varied by agreement . . ."); U.C.C. § 2-312(2) (permitting limitation of warranty provision); U.C.C. § 2-718(1) ("Damages for breach by either party may be liquidated in the agreement . . .").

37. *E.g.*, N.Y. CIV. PRAC. L. & R. 5001 (McKinney 1991).

38. Under New York law, for example, punitive damages "cannot be granted for failure to perform the obligations of a private agreement, even if the failure to perform was purposeful and in bad faith." *Morano v. Oral Research Laboratories, Inc.*, 594 N.Y.S.2d 260, 261 (1st Dept. 1993).

sically will be a routine collection action brought by one corporation against another.

7. *(the bottom line question): What should Smith's decision be in response to the outrageous offer made by Bruce Brothers?*

After the foregoing discussion with Dunn, Smith must decide how to respond to the Bruce brothers, who had pretty much indicated that their offer of \$225,000 to settle the \$250,000 invoice, payable at the rate of \$25,000 a month for nine consecutive months with interest at the rate of 6%, was a take-it-or-leave-it proposition. As Smith, what is your decision? War or peace? Litigation or settlement?

As a prudent executive, Smith concludes that he cannot afford the luxury of taking Bruce Brothers to court. Accordingly, he decides to accept the settlement offer.

The Settlement Agreement

Assume that Smith and Dunn may fashion the settlement agreement in any reasonable manner, because the Bruce brothers are fully satisfied with the delay they have achieved, the additional time they are getting, and the \$25,000 concession.

Smith would be well advised to settle for the performance of the obligations of Bruce Brothers under the settlement agreement and not for the promise of that performance. This is the difference between an accord and satisfaction and an executory accord.³⁹ Smith will be much better protected if the agreement stipulates that the entire \$250,000 is owed to him, but that the debt will be discharged by the timely payment on the dates specified of \$225,000 with interest.

Otherwise, Smith would be vulnerable to future default by Bruce Brothers. If Bruce Brothers should fail to pay promptly the installments aggregating \$225,000 as scheduled in the original settlement agreement, Smith might be faced with a demand for another concession in the sum to be paid in exchange for the prompt payment of the sum then due. If the Bruce brothers are now acting in good faith, they should have no objection to affording Smith the leverage of an acknowledgment that he is entitled to the entire original amount if Bruce Brothers does not live up to the terms of the set-

39. See generally, Comment, *Executory Accord, Accord and Satisfaction and Novation—The Distinctions*, 26 BAYLOR L. REV. 185 (1974).

tlement agreement.⁴⁰ To complete this approach to the settlement, there should also be an acknowledgment by Bruce Brothers that the goods complied with specifications.⁴¹

Obtaining a down payment should be a priority issue in finalizing the settlement agreement. We will assume, however, that Bruce Brothers refuses to make a down payment.

In considering the provisions that should be contained in the settlement agreement, it is insufficient simply to state that nine payments, each in the amount of \$25,000, will be made by Bruce Brothers in consecutive monthly intervals, starting one month from now, with interest from the present date at the rate of six per cent per annum.

The settlement agreement must also specify when interest is to be paid and on what amount. If interest is to be paid each month,

40. A case that my firm handled is germane. Our client ("Baker") was the chief executive in a shaky magazine empire ("X Corporation") who had an employment agreement that over time would have paid him \$1 million. The controlling stockholders concluded that the magazine corporation should be sold to another magazine enterprise. In order to achieve this, the controlling stockholders had to persuade Baker, who was also a minor stockholder in X Corporation, to go along with the merger. The proposal to Baker included an agreement under which he would render nominal services as a consultant to the new enterprise ("Newco") and would be paid aggregate consulting fees totalling only half of what he would have received if his employment agreement had been honored by X Corporation. For good reasons, Baker decided to go along with the transaction. On behalf of the client, we insisted that the following provision be inserted in the consulting contract between Newco and him:

"Remedies. Newco and Consultant [Baker] expressly acknowledge and agree that, in the event of any breach of the terms hereof by Newco, which breach remains unremedied 5 days after notice thereof is given to Newco by the Consultant, the Consultant shall be entitled to (a) damages equal to such amounts as would be due Consultant if Consultant were employed by Newco upon terms identical to that certain employment agreement, dated _____ between Consultant and X Corporation, and if Consultant's employment had been terminated by Newco without cause and (b) reasonable legal fees resulting from a breach involving non-payment of amounts owed hereunder."

After a period of time, Newco stopped making payments on the consulting agreement and accordingly it was necessary to bring suit on behalf of Baker. Fortunately, however, by reason of the provision of the consulting agreement quoted above, my firm was able to get a judgment for the client for a million dollars rather than for half a million dollars.

41. In my practice I represented a South Carolina manufacturer of menswear. One day the executive of the company called me and stated that there had been a dispute with a customer about whether shipped goods met specifications, etc., and that a settlement had been proposed that would (a) fix a lesser amount in full satisfaction and (b) be payable in installments. Pursuant to my advice, the client insisted on a settlement predicated on actual performance rather than on the promise of that performance.

it should be on the entire unpaid balance and not just on the particular installment of the principal then falling due.

The settlement agreement should also contain an acceleration upon default provision, providing that the entire amount will immediately become due and payable upon certain types of default on the installment payments. A provision requiring prior notice before acceleration is often included in such clauses.

Another feature of the settlement agreement should be a provision entitling Smith to a higher rate of interest (perhaps the then current market rate of interest) commencing upon the date of any default. A higher rate of interest fairly reflects Smith's concession to swallow the low six per cent rate of interest only as long as there is no default.

There are other items that would make the settlement more attractive for Smith, such as security or a personal guaranty by the Bruce brothers. We mentioned that the law generally does not award legal fees to the prevailing party. An agreement in the event of default to pay the other side's legal fees and the costs of collection is enforceable⁴² and Smith should ask for such a provision in the settlement papers.

Smith should also seek a confession of judgment. This is a device provided by law in a number of states⁴³ to expedite legal action and to minimize the cost of collecting a debt that admittedly is due or will become due upon a stated default.

There are a number of subsidiary issues not answered here. Should Smith avoid telling people, either before or after he collects the \$225,000, that the Bruce brothers are deadbeats? How should Smith respond if, some time after the debt is fully paid, Smith gets a phone call from one of the Bruce brothers who desires to place an order for another \$250,000 of merchandise? Should Smith tell the Bruce brother to get lost? Or should Smith agree to the order but require: (1) a large deposit with the order, (2) cash on delivery, (3) collateral, (4) a letter of credit, (5) a personal guaranty, (6) a higher price than would be charged to another customer?

42. See *Resnick v. Maxim Group, Inc.*, 633 N.Y.S.2d 910, 911 (4th Dept. 1995) ("Because . . . defendants are in default under the settlement agreement [they] must pay plaintiff costs and attorney's fees."); see also, *Raven Elevator Corp. v. Finkelstein*, 636 N.Y.S.2d 292 (1st Dept. 1996) (enforcing personal guaranty).

43. See, e.g., *Weinstein v. Pollack*, 617 N.Y.S.2d 344 (2d Dept. 1994); *World Color, Inc. v. Collectors' Guild, Ltd.*, 580 N.Y.S.2d 345 (1st Dept. 1992).

Conclusion

Since the American civil legal system is unsatisfactorily costly, slow and risky, a top business executive, as part of his main pursuits, should adopt the habit of a good commercial lawyer of giving thought to potential legal problems in a commercial relationship. In an attempt to avoid having an unfortunate experience such as Smith's, the prudent business executive should investigate all the parties to a contemplated transaction and should refuse to do business with anyone who has a reputation for being a dead-beat or for otherwise causing trouble. With any sizeable order for the shipment of goods, it is desirable to secure a down payment. Furthermore, taking the precaution of entering into a written contract should help considerably in avoiding legal disputes or bringing them to a satisfactory conclusion.

In the context of a delinquent accounts receivable, a business executive attempting to collect a valid debt on an oral agreement frequently will come to the unhappy conclusion that he or she is well advised to settle, not litigate. In our hypothetical involving a delinquent account receivable aggregating \$250,000, Smith should make an effort as part of the settlement to procure a down payment of an amount between \$25,000 and \$35,000. We conclude that regardless of Smith's success in that regard, Smith should accept the settlement offer by the debtor Bruce Brothers.

Any settlement agreement concerning debt collection generally should constitute an accord and satisfaction of prior debts, not an executory accord. The agreement should set forth the installment payment arrangements, including when interest will be paid and on what amount, an acceleration upon default provision, a higher rate of interest upon default, and a confession of judgment. Desirable provisions also include a down payment, security, a personal guaranty, and payment of legal fees and costs of collection in the event of default.

After this distressing encounter, Smith is determined in future business dealings to try to anticipate and to prevent the occurrence of any costly and troublesome legal problem that can be adroitly avoided.