What's Your Client's Case Worth For Purposes of Settlement?

[Some thoughts and considerations regarding pre-mediation preparation]

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1. The Uncertainty of the Litigation Outcome

When parties resort to filing a lawsuit to have their dispute decided by the court, they each know their side of the story and that they have a disagreement about what happened and what the proper resolution or outcome should be. They go to court because they cannot resolve the dispute themselves and at least one side is not willing to let the triggering incident go unaddressed. When attorneys get involved, they have no first-hand knowledge of what happened. Their involvement in the dispute comes after-the-fact and frequently involves the statement and filing of claims based upon information provided by one side (the client). As such, at the time of filing a lawsuit, there is (or should be) some level of uncertainty on the attorney's part about what actually happened and the consequences caused by or flowing from those transactions and events.

It is through the process of litigation – through investigation and discovery - that evidence is gathered and some level of uncertainty is eliminated. The legal implication of past transactions and events is evaluated through attorney research and analysis. Sometimes that analysis becomes the "law of the case" through orders obtained via pretrial motions. The fact remains, however, that no matter how much investigation, discovery, research and analysis an attorney does on the client's behalf, no one can know or predict how the court (judge or jury) or arbitrator will ultimately decide the dispute. This is especially true when equitable principles are involved or the determination of disputed issues turns upon witness credibility, conflicting facts, and/or the ability of the fact finder to understand complex facts, legal theories and/or expert witness opinion testimony. Nevertheless, clients frequently ask their attorneys to predict the outcome and expect them to do so with reasonable certainty.

The inability to predict the future with certainty presents a problem in mediation when trying to evaluate whether a settlement opportunity represents a better alternative for the client than proceeding to trial. If trial is the client's Best Alternative to a Negotiated Agreement (BATNA), what is the client's BATNA worth today as compared to the settlement opportunity that is on the table? While attorneys make "predictive judgments" about what the likely outcome at trial will be based upon their experience, research and the results of discovery taken to date, those predictions really do not amount to much more than a good, old-fashioned guess (with the possible exception of cases involving recurring fact scenarios and legal issues in the same court or jurisdiction).

Because 95% all civil litigation matters settle before trial (so the outcome at trial is never known to compare to the attorney's prediction), the assumption is that cases settle at about the right amount. A recent scientific study conducted by Randall Kiser of DecisionSet suggests that this assumption is incorrect. The Kiser Study, which examined more than 4,500 cases and 9,000 settlement decisions in California and New York, analyzed civil cases in which the parties exchanged settlement offers, the last offer was rejected and the parties proceeded to trial. Comparing the actual trial results with the rejected pretrial settlement offers, the Kiser Study found that in only 15% of the cases did both the plaintiff and defendant obtain a trial result that was better than their opponent's last settlement proposal. The study also found that 62% of plaintiffs and 24% of defendants obtained an outcome at trial that was the same or worse than the result they could have achieved by accept-

ing their opponent's last settlement proposal (before netting out the fees and costs incurred after settlement discussions failed). Although plaintiffs experienced adverse trial outcomes more frequently than defendants, the Kiser Study found that the disparity between the judgment amount and the declined settlement were significantly higher for defendants than plaintiffs. For plaintiffs, the average "decision error" cost was about $43,000, as contrasted with defendants whose average "decision error" cost was about $1.1 Million during the 2002-2005 period. Again, this analysis did not factor in the additional litigation expenses incurred after the failed settlement effort, which could affect the ultimate outcome considerably for both sides, and with respect to plaintiffs who prevailed, it did not consider the time value of money with respect to the delayed recovery.

Given the discrepancy found between rejected settlements and eventual verdicts, several commentators have questioned whether parties who settle may make similar decision errors by paying too much or demanding too little – calling these settlements "sub-optimal." Because the focus of law school and legal practice is on preparing for trial and honing the art of trying a case, one commentator has opined that too little attention is given to how to prepare for settlement or how attorneys can improve their ability to assess risk and calibrate judgments. "[I]n many cases lawyers do not believe there is a way to improve; they believe that case valuation is simply guesswork" because their valuation method does not include a rational financial analysis in which estimates are tested or assumptions are compared to objective criteria. Without this level of preparation, parties frequently are not equipped to provide reasons for their proposals and the mediation turns into a test of wills with each side simply stating (and restating) their position or demand. The purpose of this article is to take some of the guesswork out of case valuation.

2. "Discounting" the Predicted Judgment to its Present Value for Purposes of Achieving Settlement Today

As mentioned above, most civil litigation cases are settled before trial. In the context of a mediation convened to explore settlement, the prospect of a final judgment is usually an event that is months (maybe even years) in the future. So whatever has been projected as the probable outcome at trial in terms of a judgment or award needs to be "discounted" to the present, just as a stream of payments to be made over time would be discounted for a cash payment today.

Remaining Costs. One obvious "discount" factor is the amount of remaining costs and fees the client would have to spend in order to take the case through trial and post-trial proceedings to achieve a final, enforceable judgment. Most attorneys are prone to under estimating the fees and costs that will be incurred to prosecute or defend a case through trial, as well as isolated aspects of the case (e.g., how much the discovery phase will cost; how much the pretrial motion stage will cost; how much trial preparation and briefing will cost; how much post-trial motion proceedings will cost; etc.). We know this is true because clients ask for discounts or explanations or both when they receive a bill that exceeds the attorney's budget estimates. If there have been discrepancies between an attorney's historical estimates and actual charges incurred – both for the present case and cases in general - then the "remaining cost" estimate should be adjusted accordingly.

Dispositive Contingencies. One aspect of the art of litigation is taking advantage of the many procedural hurdles that can be put in the path of the other side in the hopes of eliminating some or all of that party's claims or defenses, or significantly impairing the presentation of their case. For example, attacks on the pleading seeking dismissal of causes of action; motions for summary judgment seeking to avoid trial and obtain judgment on all or some of the issues or claims; motions in limine seeking to keep key testimony or documents out of evidence; motions for directed verdict or nonsuit; post-trial motions seeking reconsideration, new trial, or a judgment notwithstanding the verdict. These are dispositive contingencies that threaten a party with their "worst case" alternative. All cases have them! Indeed, it is the rare case where the other side does not launch at least one monkey wrench at your case. These contingencies need to be identified, each contingency needs to be researched, evaluated and weighed and an adjustment to the perceived judgment value of the case needs to be made for the risk avoided by virtue of the settlement. When the client avoids a dispositive risk and the costs associated with that risk, an adjustment is in order to get a truer idea of the rational financial value of the case for settlement purposes.

Non-Dispositive Contingencies. A non-dispositive contingency is something outside the case that could affect the value of what is at issue, the finances or stability of one or more of the parties, existing or future relationships, etc. These contingencies are usually outside the parties' control and are frequently the answer to "What could possibly go wrong?" For example: Will there be publicity about the lawsuit or its outcome and, if so, will one or both parties be adversely affected? Are the par-

ties or the subject matter of the dispute affected by market conditions and, if so, if the market changes will one or both parties be adversely affected? If the case is decided, might it set a legal precedent and, if so, will one or both parties be adversely affected? Non-dispositive contingencies have unpredictable impacts. Take for example the situation where parties have a dispute over who has title or who has a superior lien position to a particular asset. At the time the dispute arose, the asset was worth "X," but by the time the dispute was decided by the courts, it was worth only 50% of "X" due to a change in the market or a decline in the economy. Market and economic changes are non-dispositive contingencies. Just like dispositive contingencies, discussed above, an adjustment to the perceived judgment value of the case needs to be made for the risk avoided by virtue of the settlement.

Other Factors. In addition to the foregoing, there are a number of additional factors that may be difficult to quantify, but may have bearing on the above weightings and cost estimates. For example: What is the judge's track record with respect to the efficient (or inefficient) management of a trial? Does the judge have a record or known predisposition with respect to pretrial motions to exclude evidence, jury voir dire, foundational issues related to qualification of experts or use of scientific information? Has the judge decided similar issues in other cases and, if so, which way has he/she ruled? What is the experience or skill level of the attorney(s) on the other side? What is the known or perceived ability (or inability) of the defendant(s) to satisfy a judgment? These are risk factors. So, when a risk is to be avoided through settlement, an adjustment to the perceived judgment value of the case is in order.

3. The Role of Cognitive Barriers on Decision Making

This discussion about how to evaluate the settlement value of a case would not be complete without mentioning a few of the "cognitive barriers" that influence our perception of risk and our understanding of the problem. These barriers to understanding and reasoning need to be acknowledged so that their impact on our evaluations and decision making can be managed.

Overconfidence and Confirmation Biases. "Overconfidence" is defined as being excessively confident or having unbounded optimism. The Greeks called it hubris (or pride) and labeled it one of the seven deadly sins. The effect of overconfidence is a well-established bias in which someone's subjective confidence in their judgments is greater than the objective accuracy of those judgments. Overconfidence is a cognitive barrier because it allows us to believe or feel that we know more than we really know and increases the odds of impasse in a negotiation setting. Overconfidence leads people to discount low probabilities and to overestimate attractive consequences.

Overconfidence goes hand-in-hand with "confirmation bias," which causes us to seek out evidence that confirms an existing belief, theory or hypothesis, and to place more emphasis on facts that support our desired outcomes and to discount or disregard contradictory evidence. This bias is self-confirming. The more evidence we accumulate in support of our position, the more firmly we hold on to that belief and the less inclined we are to consider anything to the contrary. Litigation is like a Petri dish for confirmation bias because it builds a case around one side of the story and encourages sorting through facts to find those that fit our theory of the case (disregarding or discounting those that do not). Overconfidence and confirmation bias present challenges in mediation because they result in a miscalibration of subjective probabilities and a misperception of objective realities.

Risk Attitudes. Some people are more risk averse than others, and some people are risk seekers in the sense that what looks like an unwise gamble to most would look like a gamble worth taking to the person with an exceptionally high tolerance for risk. Without determining how much more risk tolerant or risk adverse one party is as compared to the other in a particular dispute, there is an important generality that exerts strong cognitive influence on how settlement is viewed. Researchers have found that risk attitudes are dependent on whether the party is facing a gain or a loss. For the most part, plaintiffs seek recoveries that defendants do not want to pay. In the context of settlement, the plaintiff is presented with a sure gain versus the possibility of a larger gain after trial, and the defendant is presented with a sure loss versus the potential of a larger loss after trial. In one study, the majority of subjects facing gains preferred the certainty of receiving a $250 payment over a 25% chance of $1,000 (worth on average $250). That same group preferred a 75% chance of losing $1,000 (worth $750) to a sure loss of making a $250 payment. Beyond the general preference of defendants to take a chance on not losing at trial and plaintiffs' general preference for a sure gain through settlement, the parties' willingness to settle is driven by their attitude towards risk.

So how does the risk attitude of a lawyer and of his/her client affect preparation for and participation in mediation? Theorists describe risk attitude

as "a chosen response to uncertainty that matters, driven by perception." For lawyers, the uncertainty that matters is the likelihood that the client's position will win the day at trial. The question is how does the lawyer's risk attitude affect their projections of trial success and how does the client's risk attitude affect their predisposition to settle or litigate.

Risk attitude is driven by perception. Our perceptions are affected by many factors, including: (1) conscious rational assessment; (2) subconscious sources of bias; and (3) affective inner emotions. These three factors were identified by two researchers who coined the phrase "The Triple Strand" influences on perception and risk attitude.

The first factor, rational assessment, is the bread and butter of legal analysis and the sole factor attorneys will claim as the basis for their personal risk attitude. The third factor, our emotions, may be surmised from the facts, or, in many cases, are often on display during discovery and the mediation conference for all to evaluate. The difficulty arises from the significant influence of the second factor, subconscious sources of bias and/or non-rational factors which influence our perception of a given risk.

Subconscious sources of bias and/or non-rational factors that affect our risk perception in a litigation context include:

Control. Where we believe we have control, we have a lower perception of risk. Travelling by car is a good example. We feel more comfortable (less at risk) as the driver of a car than as a passenger. In litigation, the party initiating the lawsuit or filing the motion may feel like they are in a position of control and thus have a lower perception of the uncertainty attached to the outcome of those proceedings.

Novelty. New risks appear to be greater than risks we are accustomed to. For example, genetically modified food is viewed as more risky than food which has been treated with pesticides. One is new. The other has been an accepted part of agriculture during our lifetimes. In the context of litigation, the level of experience the parties and / or their counsel have had with the court system or with arbitration will influence their perception and understanding of risk. The more successful experience one has had, the lower the perception of risk.

Risk-benefit trade-off. We tend to discount risk when there is a perceived benefit as well as a threat. For example, smoking cigarettes and driving after drinking are examples where the risk is discounted because of the pleasure or relief experienced from smoking or drinking. In the context of exploring settlement, this influence is evidenced when parties and/or their counsel severely discount the risk of losing at trial, which is due at least in part to the focus on the pleasure, relief and perceived benefit of winning – either winning big or being completely exonerated.

Trust. We tend to downgrade risk depending on whether we have or do not have "protection" from a trusted party. For example, the visible presence of law enforcement causes us to downgrade the risk of being the victim of a crime in the community where we live, on the streets that we travel, etc. In the context of litigation, the client's trust and confidence in his/her attorney may cause the client to downgrade the risk of going to trial – especially if the attorney expresses confidence in "winning." It also explains why parties are frequently unable to make the decision to accept or reject a settlement offer without their attorney's advice.

Some academics argue that risk attitude can be managed consciously; that emotionally-literate individuals and groups respond instead of react when they understand what drives or influences their perception of risk. The challenge for attorneys and their clients is to manage their risk attitude when evaluating settlement as compared to proceeding with the litigation.

4. Conclusion

Since most of all civil litigation matters settle before trial, the chances are your client's case will likewise be resolved by settlement – not trial. Nevertheless, the trial outcome is the backdrop against which settlement offers are frequently made and rejected. While the projected / estimated trial outcome may be an appropriate starting point, this article suggests that various adjustments need to be made to take into consideration the litigation costs not incurred and the risks avoided with respect to dispositive court proceedings or circumstances and events beyond our control so that "meaningful" settlement opportunities can be recognized when they are placed on the table for consideration. It is the expectation of this article that each party's pre-mediation analysis of the settlement value of its respective case would be confidential and would not be the subject of the mediation, except to the extent the parties were willing to share some part of their analysis in order to explain the reasoning or thought behind a settlement proposal.