LITIGATION RISK ANALYSIS™ AND ADR

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HOW LITIGATION RISK ANALYSIS WORKS

§ 17.1 ADR and the Need to Evaluate the Risks of Trial

Alternative dispute resolution (ADR), both binding and nonbinding, is enjoying tremendous popularity today. Legal conferences and publications are devoting more attention to the various ADR options and their successful outcomes. Law schools are developing new courses to teach it. This popularity is easily understood when one considers the tremendous financial and human costs involved in the long process of litigation. Less expensive and disruptive alternatives are clearly a welcome sight. *Nonetheless, one should always evaluate the risks faced if the case were to proceed to and through trial.*

Consider first nonbinding ADR. Nonbinding ADR is, at least in part, a means of learning more about the strengths and weaknesses of one's case. Depending on its structure, it can offer the chance for counsel and clients on both sides to hear and test witnesses; to observe the reactions of a neutral third party to each side's evidence witnesses, contentions, and lawyers; and to learn the opinion of a neutral third party on the legal issues. As such, it can be an excellent and cost-effective means of permitting each side to make a more realistic appraisal of its case.

However, because of its nonbinding nature, its results are never a substitute for a trial's results. At its conclusion, counsel and client still must decide on those terms under which settlement would be preferred to full litigation. And because the reactions and opinions of one neutral third party (be it one person or one jury) constitute too small a survey from which to conclude exactly how the trial judge and jury will rule, and because each side is now able to shift its trial strategy and overcome (or at least minimize) some of the problem areas that surfaced during its nonbinding presentation, counsel must be able to evaluate in quantitative terms the risks of proceeding to trial if they are to make the best settlement recommendation following nonbinding ADR.

Binding ADR, in contrast, does substitute for trial. But when is it better than trial? Although in many instances it may be a far less expensive option, that alone does not always make it better. Counsel must also conclude that the odds of winning and the magnitude of the award are almost as good as (or better than) at trial. However, this conclusion may not be easily drawn without a rigorous, quantitative analysis because

1. The trier is different
2. The amount of information discovered may be far less
3. The length of the proceeding may be far shorter, and
4. The method of presentation may be very different than at trial.

Therefore, whether counsel is considering nonbinding or binding ADR, an important role exists for Litigation Risk Analysis™ decision tree analysis: If you are contemplating nonbinding ADR, how will you appraise the risks of trial and shape the client's settlement position based on what is learned? If you are contemplating binding ADR, how do you decide whether its risks are preferable to those faced at trial? Only by utilizing Litigation Risk Analysis techniques can ADR be used most effectively.

Before describing the use of Litigation Risk Analysis within the ADR framework of mediation, arbitration, minitrials, and the like, however, it is well to point out a conceivable danger of any of these ADR procedures, especially in the commercial context. Might their availability mean that the consequences of legal disputes are shaped by third parties more often than they should be? That is, might the *traditional* alternative to litigation—

settlement negotiations involving only the adversaries—be ignored even though it might have proven the best alternative? Settlement might be the fastest and cheapest way of resolving some disputes, and it might offer the parties the best opportunity of devising a creative solution more financially attractive to both sides than could be devised by some third party. But attempting settlement might get pushed to the bottom of the list of ADR procedures because it can often be such a difficult one, especially at the early stages of a case when its cost-saving features would be greatest. Planning one's settlement position requires trying to predict—based on incomplete information—what the judge and jury will do with the case. It also requires a willingness to live with the notion that full discovery (and trial) might have proven that counsel left too much on the table. ADR may sometimes appear much easier and safer because a neutral third party suggests what to do. But that does not mean it is always better.

In the rush to embrace ADR, therefore, corporations should not lose sight of the fact that just as ADR is often less expensive and offers more flexibility than trial, settlement with no neutral third party involvement may often be even less expensive and offer even more flexibility than ADR. Despite the number of uncertainties that exist at the early stages of litigation, Litigation Risk Analysis can facilitate settlement early on—and in ways that even those familiar with decision tree analysis may not have realized. **Sections 17.4** through **17.13** discuss how such an analysis can greatly improve the traditional settlement process. A description of how it can also play an important role in other ADR procedures appears in **§§ 17.14** through **17.18**. A brief review of how to perform a Litigation Risk Analysis follows in **§§ 17.2** and **17.3**.

§ 17.2 Evaluating Litigation Risks

Hypothetical example.[1] Your client, D, has been sued under the Age Discrimination in Employment Act for constructively discharging P because of his age. P, age 67, and two other managers (ages 63 and 36) were demoted six months ago as part of a series of personnel changes designed to "restore vitality and profits" to your company, a manufacturing firm that had fallen on hard times. P was reassigned to clerical duties, given a small windowless office, and told to deal only with his replacement and not the executives to whom he had previously reported. Rather than accept these conditions, P quit. Of the other two demoted managers, the younger one also quit, but the older one has stayed on the job. It is unclear whether or not P was really damaged, because he may have been planning to retire anyway, and it is also unclear whether or not any damages would be doubled by the court ("liquidated damages") on the ground that your client's violation was willful. If D loses, it would also be responsible for P's legal fees, though the ultimate amount of these is quite uncertain at this early stage.

Performing a good risk analysis requires three principal steps:

(i) Identify uncertainties. Counsel for D first must identify the important uncertainties in the case and capture them in the form of decision trees. (See **Figures 17-1** and **17-2**.) The uncertainties may relate to legal or factual questions or to issues of liability or damages. They are deemed important if the overall chance of losing, or the magnitude of the financial consequences of losing, depends greatly on their resolution.

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[1] I wish to thank Sozeen J. Mondlin, Deputy General Counsel, National Railroad Passenger Corporation (Amtrak), for her assistance in developing this hypothetical example. The hypothetical was constructed a number of years ago and an analysis might look substantively different today. Nonetheless, the process for performing the analysis would be identical.

Figure 17-1.

BUILDING DECISION TREE FORCES THOROUGH UNDERSTANDING OF IMPORTANT ISSUES

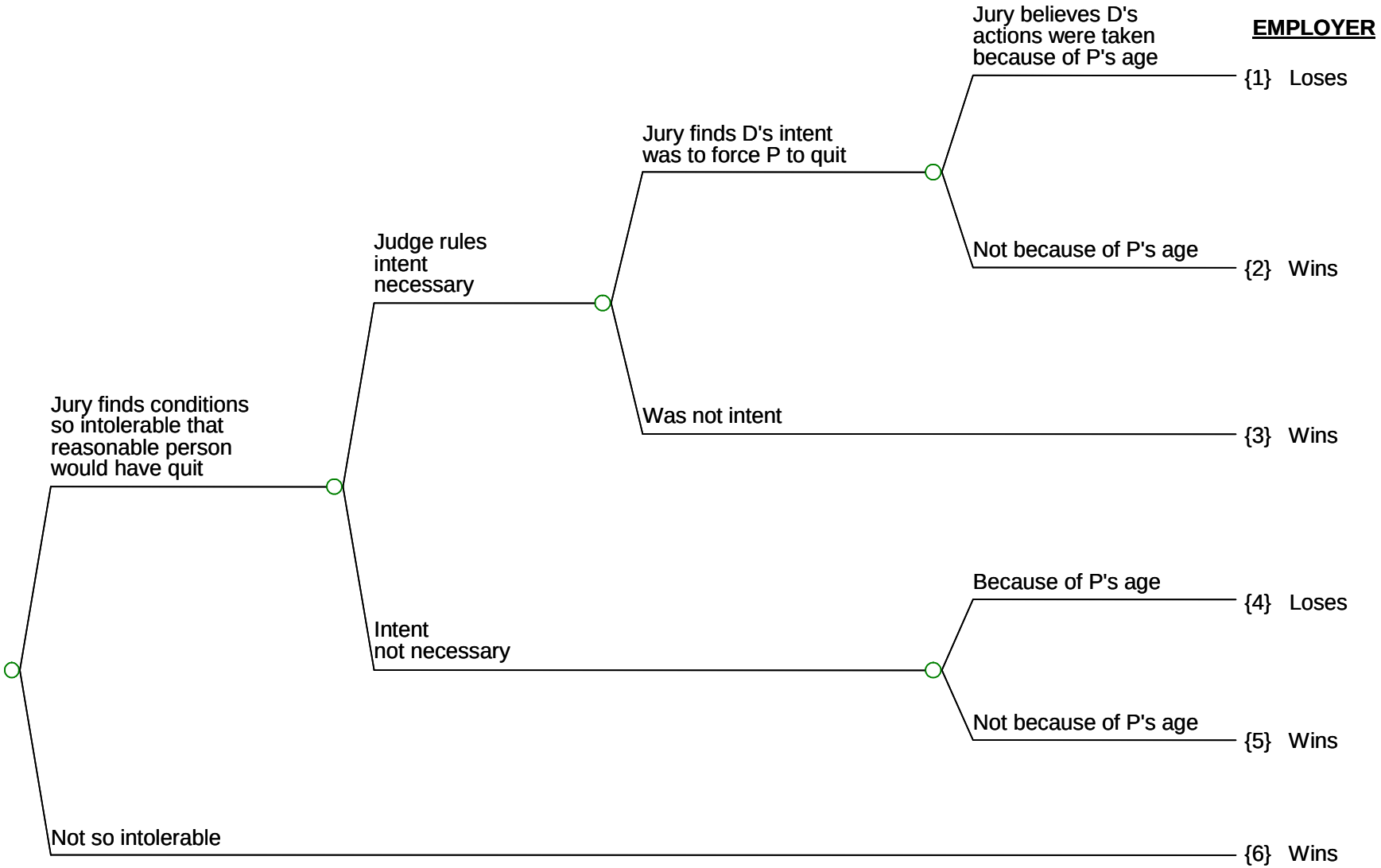
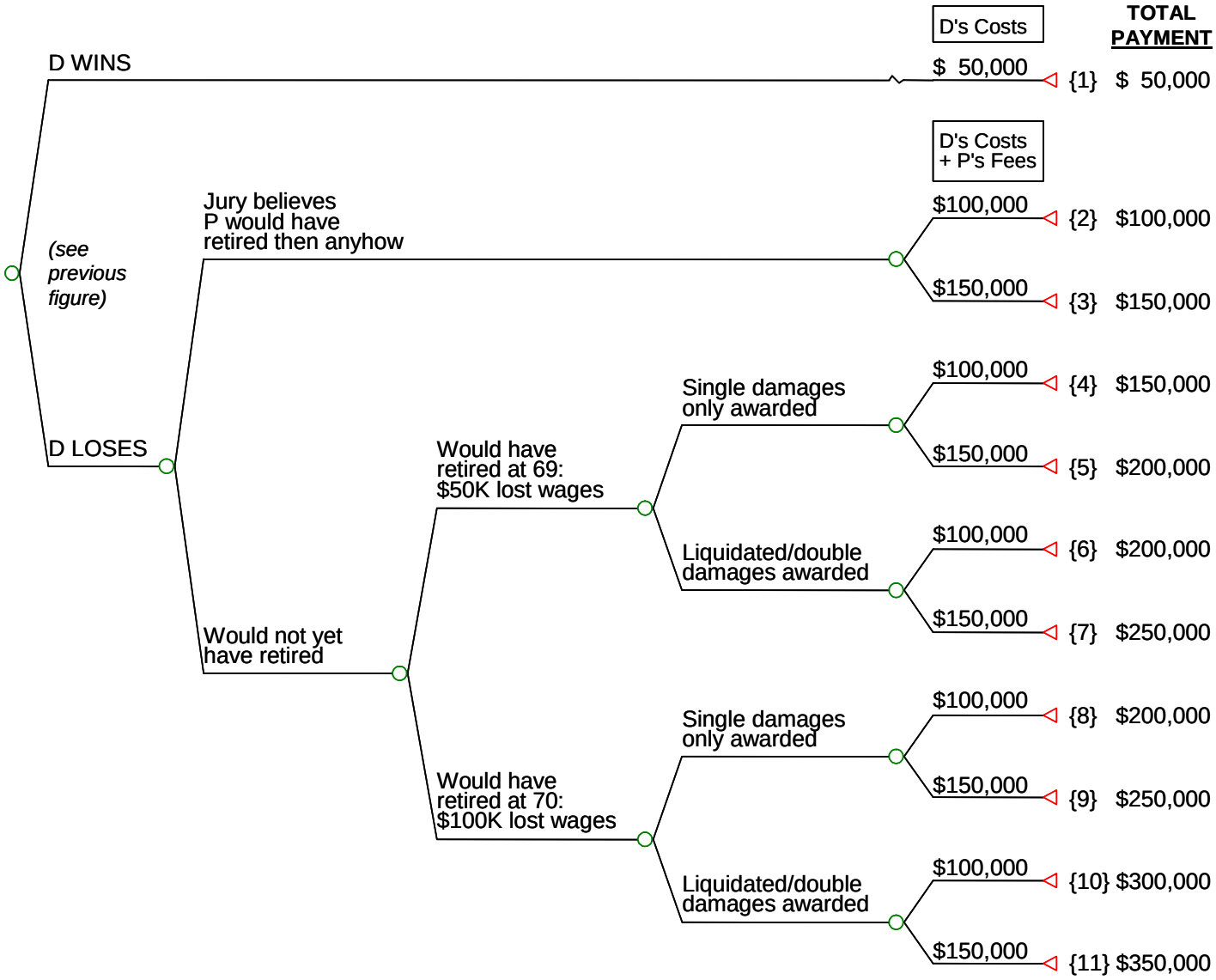


Figure 17-2.

BUILDING DECISION TREE FORCES THOROUGH UNDERSTANDING OF IMPORTANT ISSUES



In this case, we see in **Figure 17-1** that counsel believes that the threshold question influencing whether the employer loses the case is whether the jury finds the conditions accompanying the demotion were so intolerable that a reasonable person would have quit. If not, it is felt that the jury will be unsympathetic to P and return a verdict for the employer. If, on the other hand, the jury does find the conditions so intolerable, the employer does not automatically lose. First, the judge might rule as a matter of law that D actually had to intend for P to quit. If this is the ruling from the bench *and* the jury finds that D's actions were not taken with the intent of forcing P's resignation, then D will win. And even if such an intent is demonstrated to the jury, the employer will lose only if the jury finds that its actions had been motivated by the employee's advanced age rather than his poor performance. Finally, even if the judge rules that intent is not a necessary element of the claim, the jury must still consider the question of D's motive: Did the employer demote P and create the intolerable conditions because of P's age or because of his performance relative to the job's requirements?

The magnitude of P's recovery should liability be found is also uncertain. **Figure 17-2** shows the possible financial outcomes to D, including an estimate of its own fees and other litigation costs.

(ii) Reasons for favorable and unfavorable findings. The second step in a good risk analysis is for counsel to think of all the reasons why the judge or jury might eventually decide unfavorably on each of the issues shown in the tree. What harmful evidence might the plaintiff be able to introduce? How sympathetic a witness is P? How might our witnesses hurt us, or why might they not be believed? What rulings from the bench might adversely affect the outcome of the issue? It is essential to record all of the possible reasons. (See **Figures 17-3** and **17-4**.)

Now reverse the questions and list all of the reasons, issue by issue, why the judge or jury might eventually find for *your* side. If several lawyers are involved in the case, they should go through this process together, not individually. Experience has shown that the lists are always more complete and helpful in anticipating the results of future discovery if developed in this manner. This suggests that even if the case is in the hands of a single lawyer, it would be well worth outlining the issues briefly to a colleague and then asking for his or her thoughts on what might influence the court to come out one way or the other.

(iii) Quantitative evaluation. The third important step is for counsel to evaluate each of these uncertainties quantitatively, in terms of probabilities. Quantitative evaluations have a number of advantages over qualitative ones,[2] two of which are especially important for this discussion.

First, the use of phrases such as "good chance" or "some possibility" usually means that counsel has not thought as hard as possible about the uncertainty. That is, the fuzziness of such phrases may reflect the fuzziness of the lawyer's thinking on the underlying issue. Being forced to think whether "good chance" is more like even odds (50 percent), three-to-one odds (75 percent), or something else, almost always clarifies counsel's own view of the issue.

Second, even if two attorneys arrived at the same *qualitative* evaluation of each of the uncertainties in the decision tree, it is unlikely that, in combining all of their separate evaluations, they would arrive at the same *overall probability* of winning the case. This should be clear from a review of **Figure 17-5**. What conclusion would you reach on the overall chance of the

[2] Victor, *The Proper Use of Decision Analysis to Assist Litigation Strategy,* 40 Bus. Law. 617 (1984).

Figure 17-3.

REALISTIC EVALUATION REQUIRES EXAMINATION OF WEAKNESSES AS WELL AS STRENGTHS

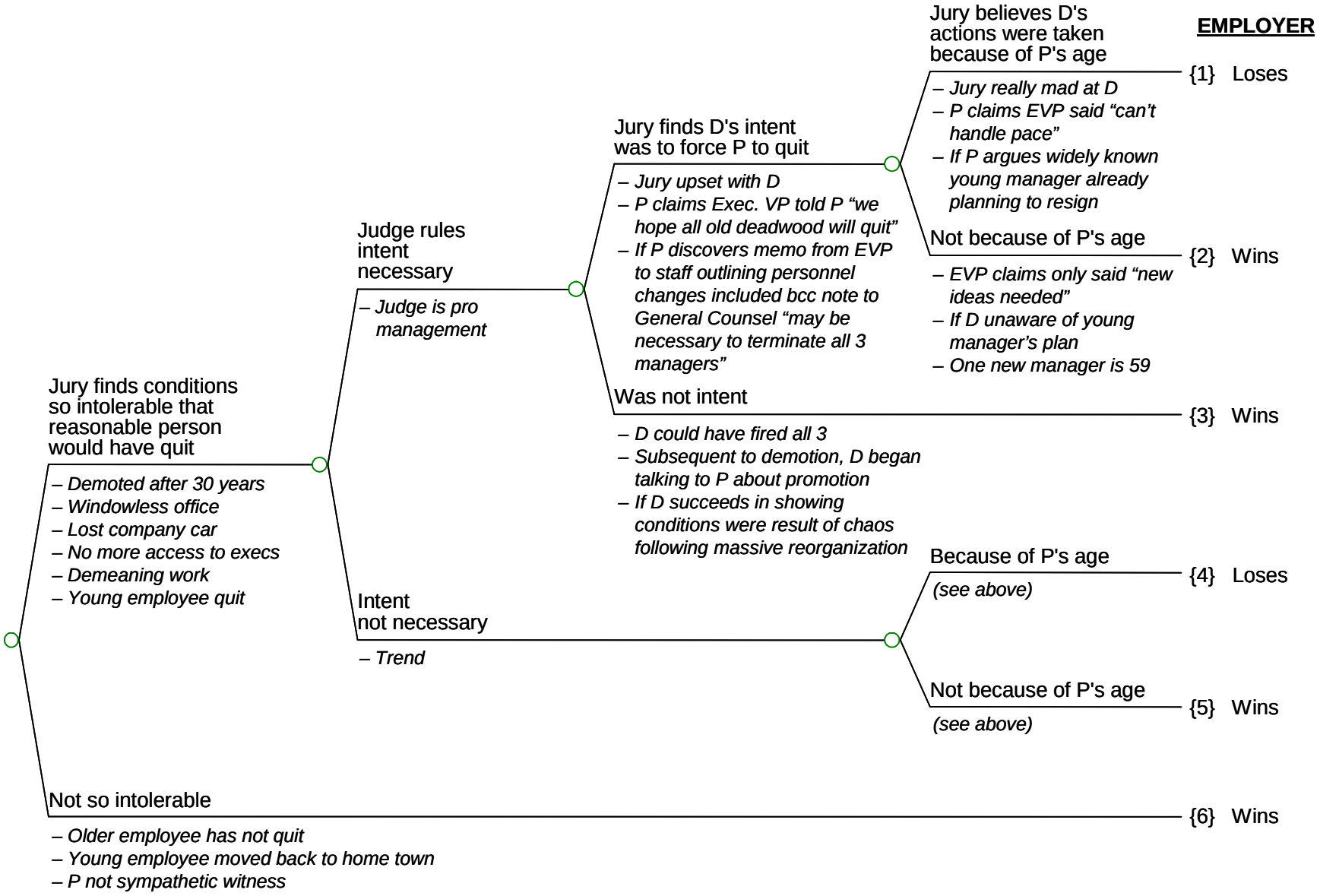


Figure 17-4.

REALISTIC EVALUATION REQUIRES EXAMINATION OF WEAKNESSES AS WELL AS STRENGTHS

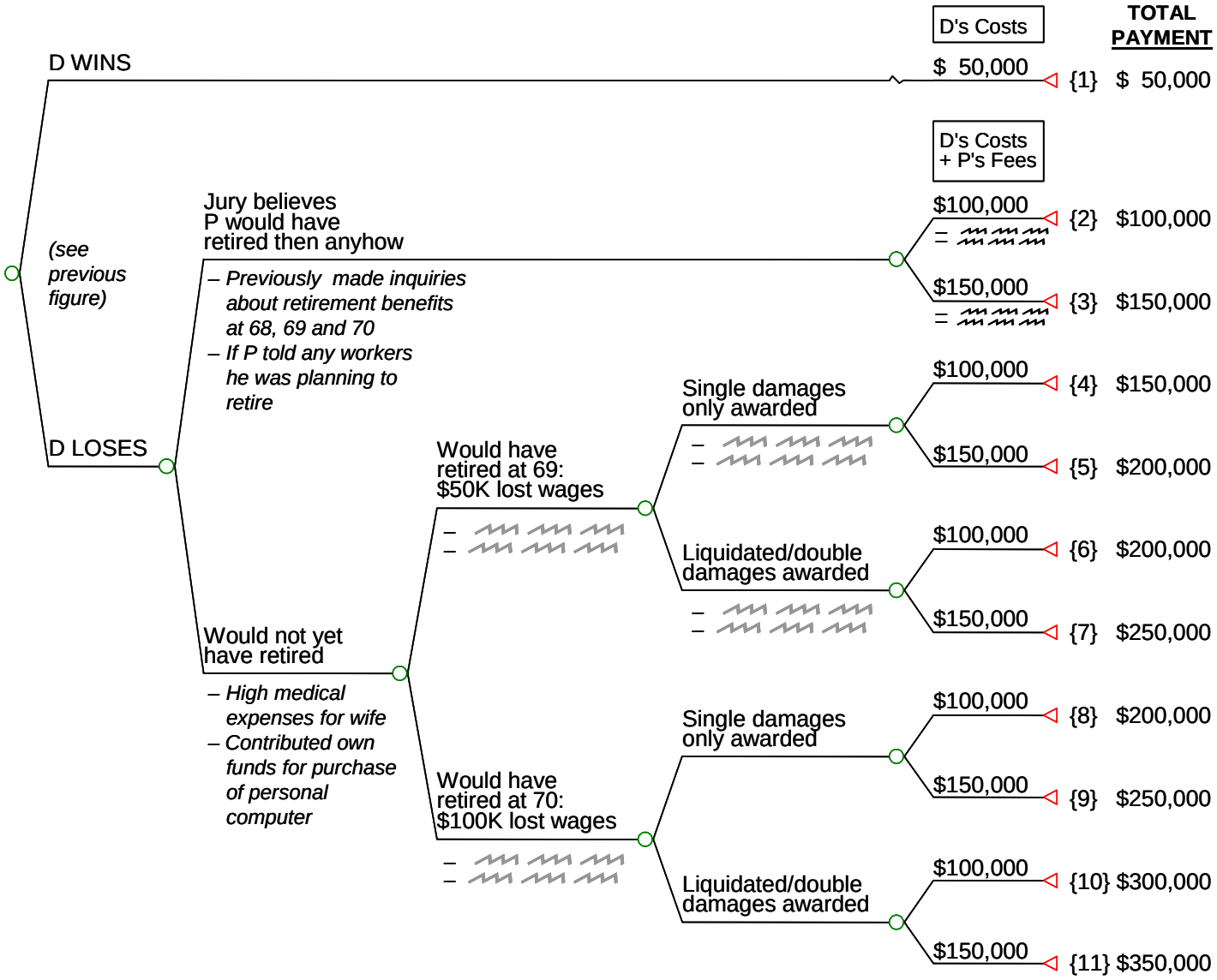
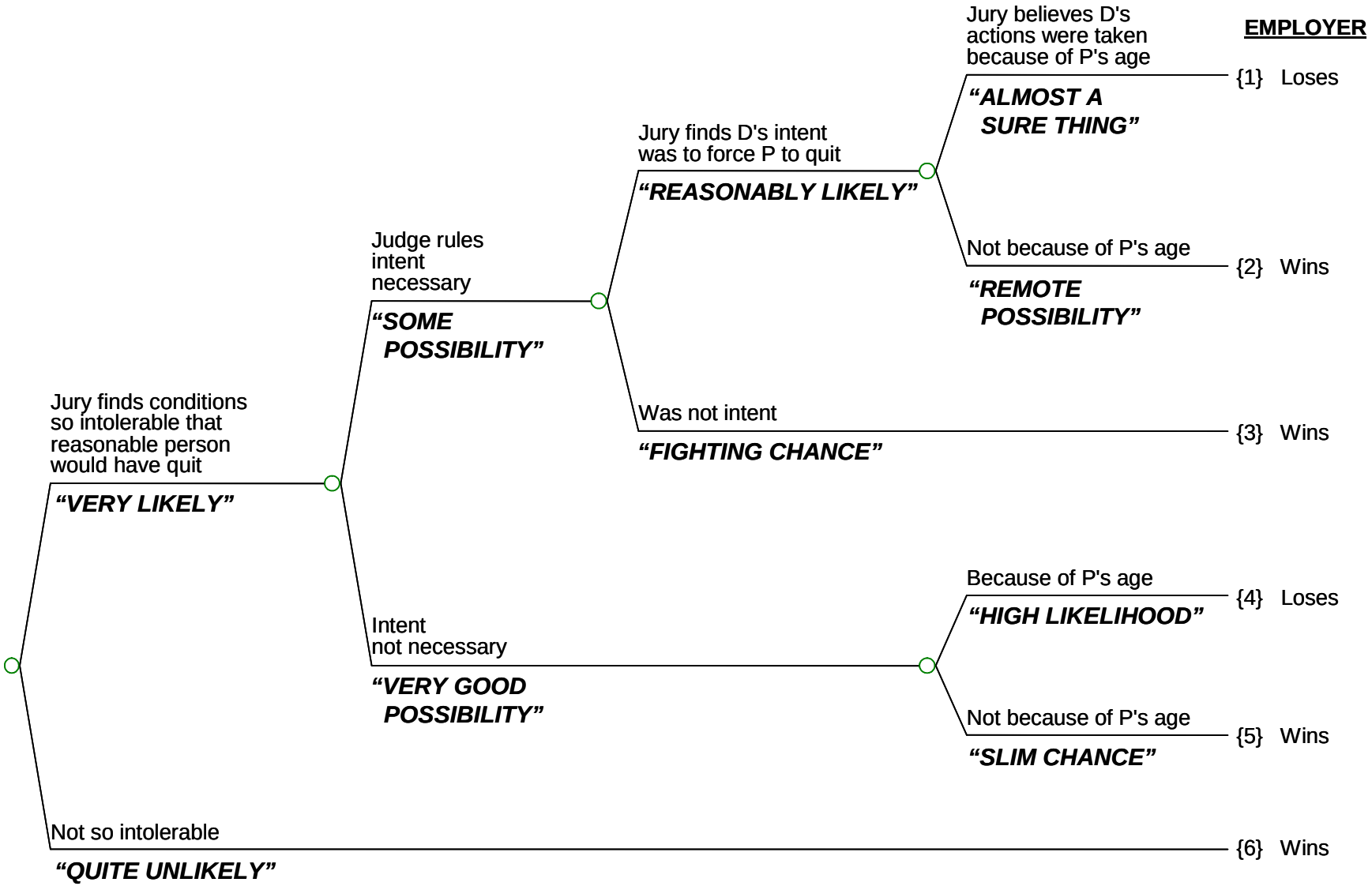


Figure 17-5.

QUALITATIVE EXPRESSIONS OF UNCERTAINTY ARE TOO VAGUE



employer winning? Can you imagine someone else reaching a different conclusion (maybe even a very different one), even though they had used exactly the same words on each of the branches of the tree? A good valuation process is one that always produces the same overall result when two people are in agreement on each of the underlying components. Obviously then, *qualitative* expressions of uncertainty cannot be used. Only by using *probabilities* can one be confident of a good valuation.[3]

§ 17.3 Calculating Litigation Risks

It is not the purpose of this chapter to teach the reader how to fully perform a Litigation Risk Analysis but rather to instill an understanding of the value of such an analysis and how it can be effectively used.[4] For purposes of brief explanation, however, the probability of the top scenario in **Figure 17-6** is calculated by multiplying .80 times .25 times .67 times .90, equals .12 or 12 percent. The probability of the next scenario is .80 times .25 times .67 times .10, equals .013 or approximately 1 percent. In fact, were it not for rounding off, the probability of the second scenario would be exactly one-ninth of the probability of the top scenario because the two scenarios differ only with respect to the last issue—does the jury believe D's actions were taken because of P's age or not?—and the top branch is 9 times as likely as the one below it (.90 versus .10). The probability of the third scenario from the top is .80 times .25 times .33, equals .067 or approximately 7 percent. Notice also that the sum of the first three scenarios is 20 percent, which is the same as .80 times .25. This make perfect sense because the first three scenarios all involve a finding of "… conditions so intolerable …" and "… intent necessary."

The probability of the fourth scenario is .80 times .75 times .80, equals .48 or 48 percent; of the fifth scenario, .80 times .75 times .20, equals .12 or 12 percent. Again note that the ratio of the probability of the fourth and fifth scenarios (4:1) is the same as the ratio of the probabilities assessed for the issue "because of P's age or not." Finally, the probability of the bottom scenario is simply .20 or 20 percent.

The sum of all the probabilities just calculated is, as logic would dictate, 100 percent. Of course, the probability of each of the scenarios is merely a reflection of counsel's judgment about each of the uncertainties comprising that scenario; nonetheless, it is the most reasonable conclusion to be drawn from each of the judgment calls made by counsel and reflected under the branches of the tree.

The second, third, fifth, and sixth scenarios result in defense verdicts; the first and fourth, in plaintiff verdicts. It is appropriate to aggregate the probabilities of these groups of scenarios to determine the overall odds of victory by each side. Thus to determine the chance of a defense verdict, one should add together the probabilities of the "Wins" scenarios: 1 percent plus 7 percent plus 12 percent plus 20 percent, equals 40 percent. To determine the chance of a plaintiff verdict, add the "Loses"

[3] The analysis should be dated. As the case progresses, new information will be learned. This will result in changes to the probabilities and possibly the decision trees themselves. This does *not* mean that the earlier analysis was wrong. It simply means that evaluations are a function of information. Because information is costly to obtain—both because discovery and legal research are expensive and because early, favorable offers to resolve a dispute may be withdrawn if not accepted on the spot—counsel had better try to evaluate the case even when lots of uncertainty exists. The risk analysis can then be used to help identify those instances in which it would actually be better to continue with discovery and get more information rather than resolve the dispute early. This is illustrated in **§ 17.5**.

[4] *See* Victor, *How Much Is A Case Worth?*, 20 Trial 48 (July 1984), for a description of the Litigation Risk Analysis process.

Figure 17-6.

PROBABILITIES SHARPEN THINKING & ALLOW LOGICAL CONCLUSIONS

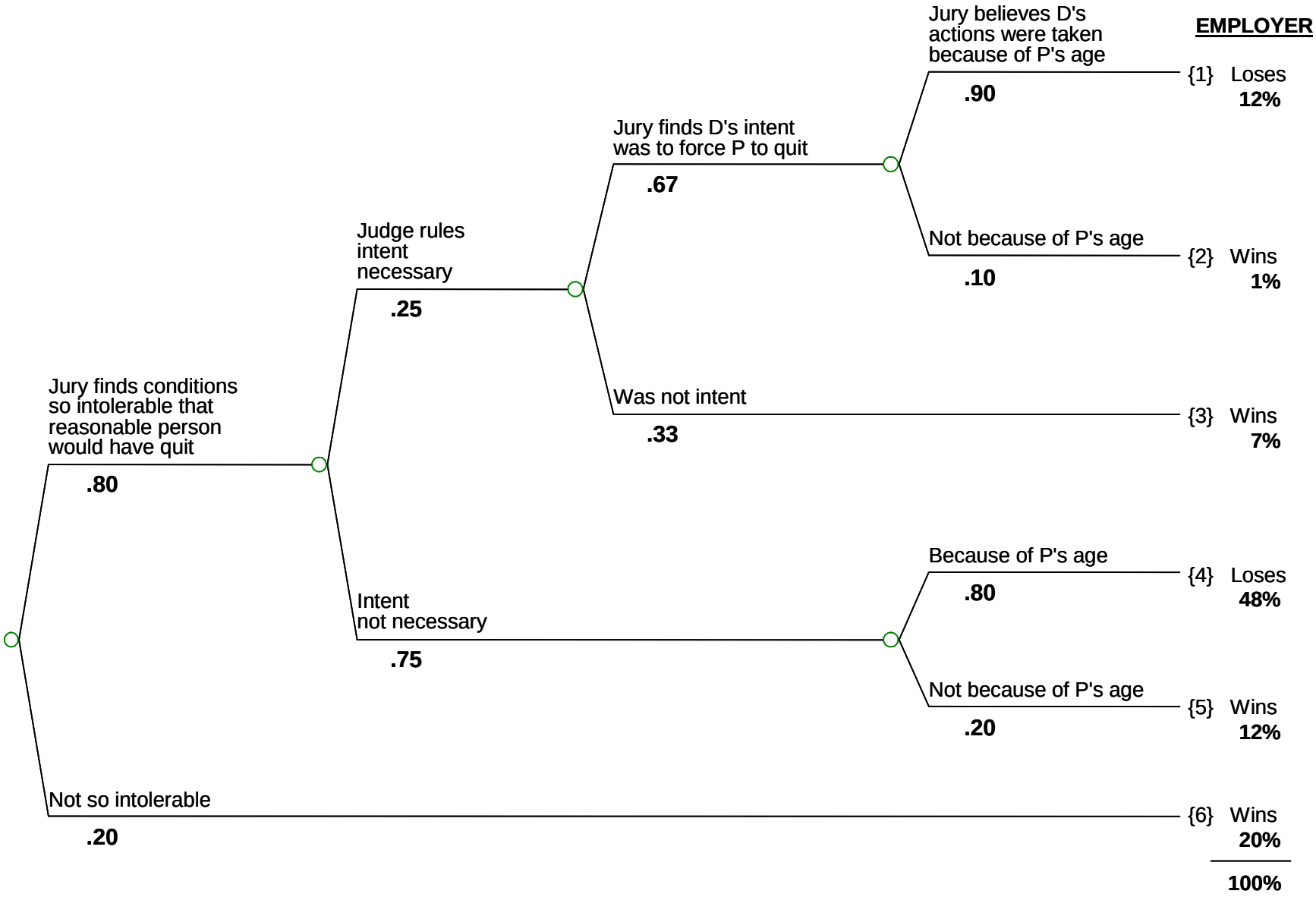
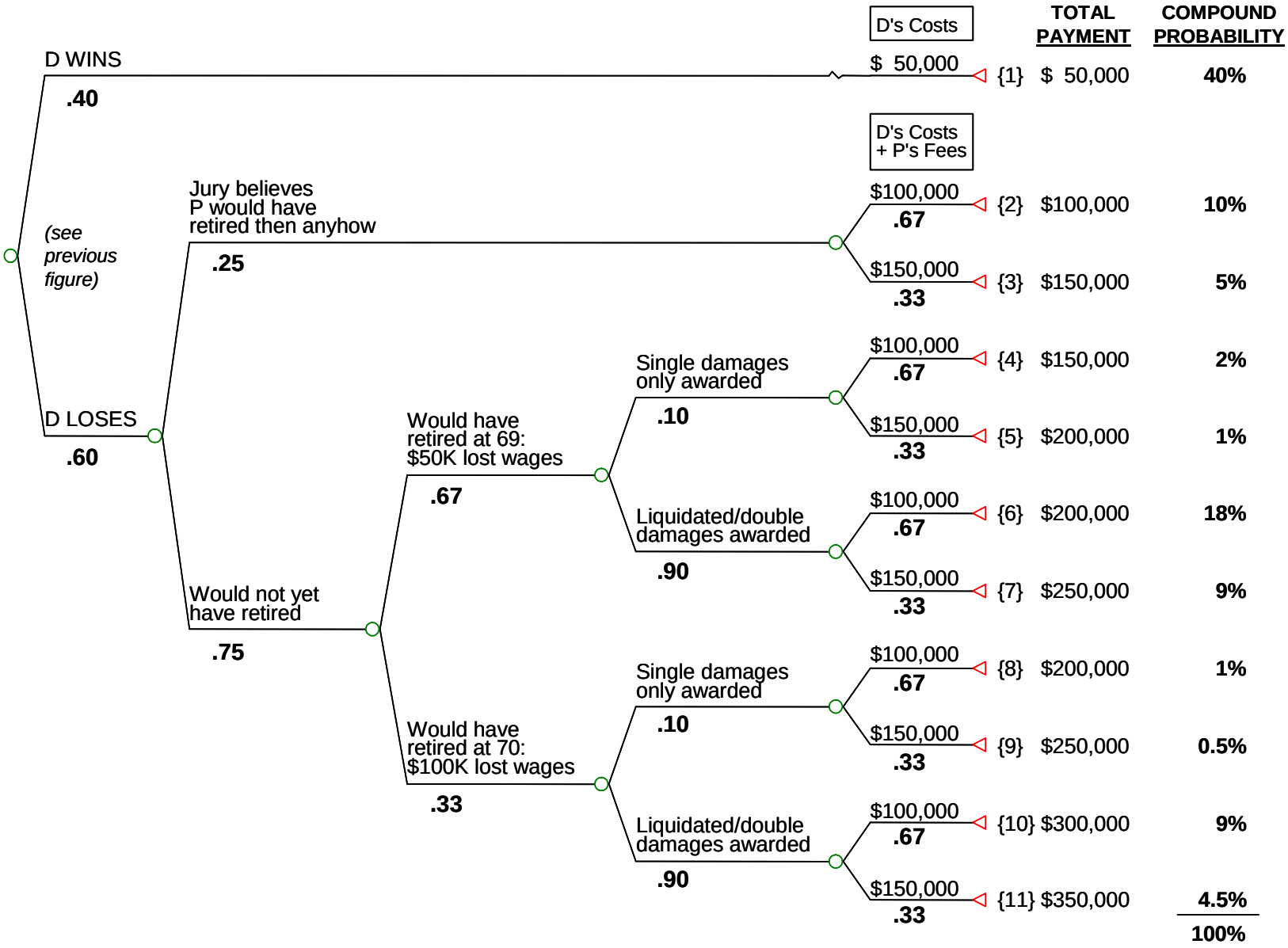


Figure 17-7.

PROBABILITIES SHARPEN THINKING & ALLOW LOGICAL CONCLUSIONS



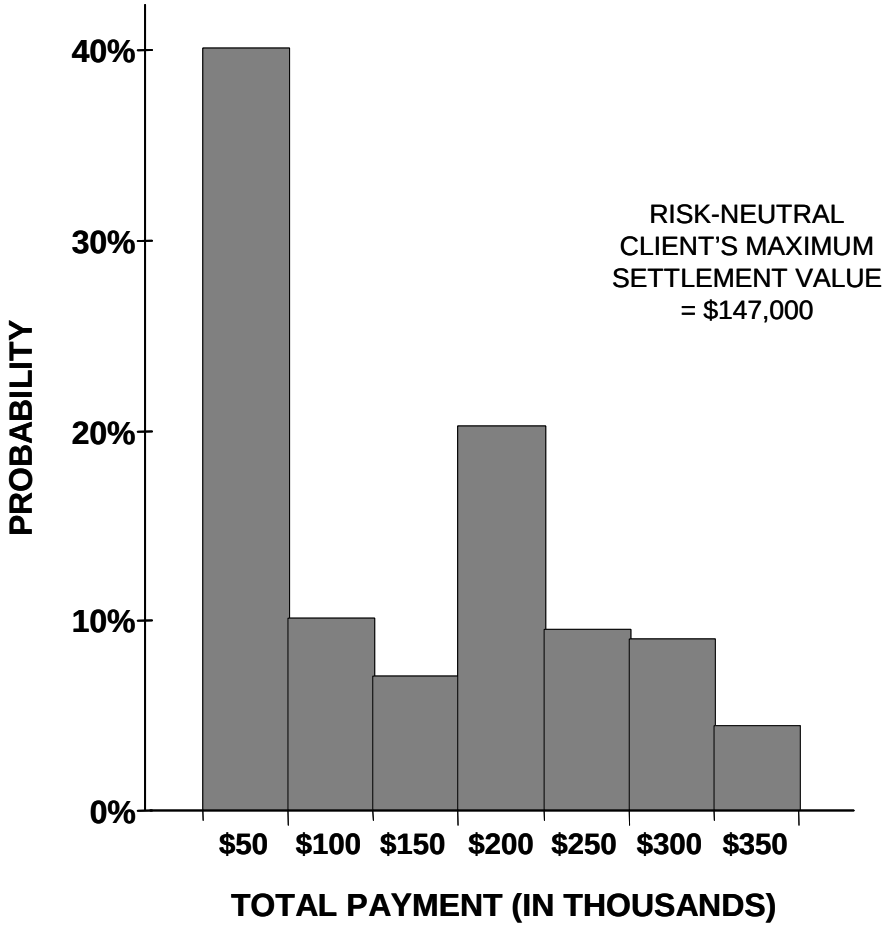
scenarios: 12 percent plus 48 percent, equals 60 percent. These are the probabilities that are entered onto the first uncertainty of **Figure 17-7**. The probabilities showing in the last column of **Figure 17-7** are then arrived at using the same process of multiplication described above.

The end result is a probability distribution such as **Figure 17-8**, showing the magnitude and likelihood of the risks faced. It is prepared by grouping scenarios of similar dollar outcomes and aggregating their probabilities. The dollar value that the client then assigns to a resolution by litigation will be dependent on its attitude toward risk-taking. The client who is not risk-averse would be willing to pay up to the probability-weighted average value: (40 percent times $50,000) + (10 percent times $100,000) + … + (9 percent times $300,000) + (4.5 percent times $350,000) = $147,000. This is known as the *expected value*. A risk-averse client, however, might well look at **Figure 17-8** and decide it was willing to pay up to $200,000 to protect against the nearly 25 percent chance of losing $250,000 or more in litigation.[5]

Other consequences of going to trial versus settling—in particular, the effect on other pending or potential litigation—can also be quantified and combined with the client's valuation of the immediate action.

Figure 17-8.

PROBABILITY DISTRIBUTION SHOWS CLIENT UNAMBIGUOUS VIEW OF COUNSEL'S JUDGMENTS



[5] *See* Victor, *The Proper Use of Decision Analysis to Assist Litigation Strategy*, 40 Bus. Law. 617, 621 (1984).

ADVANTAGES OF RISK ANALYSIS

§ 17.4 Earlier Quantitative Evaluation[6]

If counsel feels overwhelmed by the number of uncertainties presented by a lawsuit, which is especially likely when most of discovery remains unfinished, counsel's natural tendency is to resist thinking hard about a reasonable settlement, thereby dooming the possibility of an early, cost-saving, resolution. Experience has shown, however, that the decision tree gives attorneys a means of sorting out and organizing uncertainties in a case, regardless of their number. It has also shown that counsel knows quite a lot before any formal discovery begins, based on the "record" of documents, memos, and notes of conversations that was built prior to the dispute becoming a lawsuit; and that experienced counsel is good at anticipating the many things that may surface from formal discovery. Finally, experience has established that once the reasons for possibly winning or losing on each of the issues shown in the tree have been articulated and recorded, counsel is much more comfortable assessing the odds (in quantitative terms). Thus in many cases, the exercise of performing the decision tree analysis allows the settlement process to get off the ground, whereas without it, counsel might postpone even thinking about settlement for quite some time.

§ 17.5 Identifying Deal Breaking Uncertainties

Having made initial assessments of the various uncertainties in a tree, counsel can identify those issues about which having more information would be critical to determining the client's settlement amount. This can be done with a *sensitivity analysis*, in which the probability of a particular outcome on a particular issue is varied and then the difference in settlement value resulting from this change is calculated.

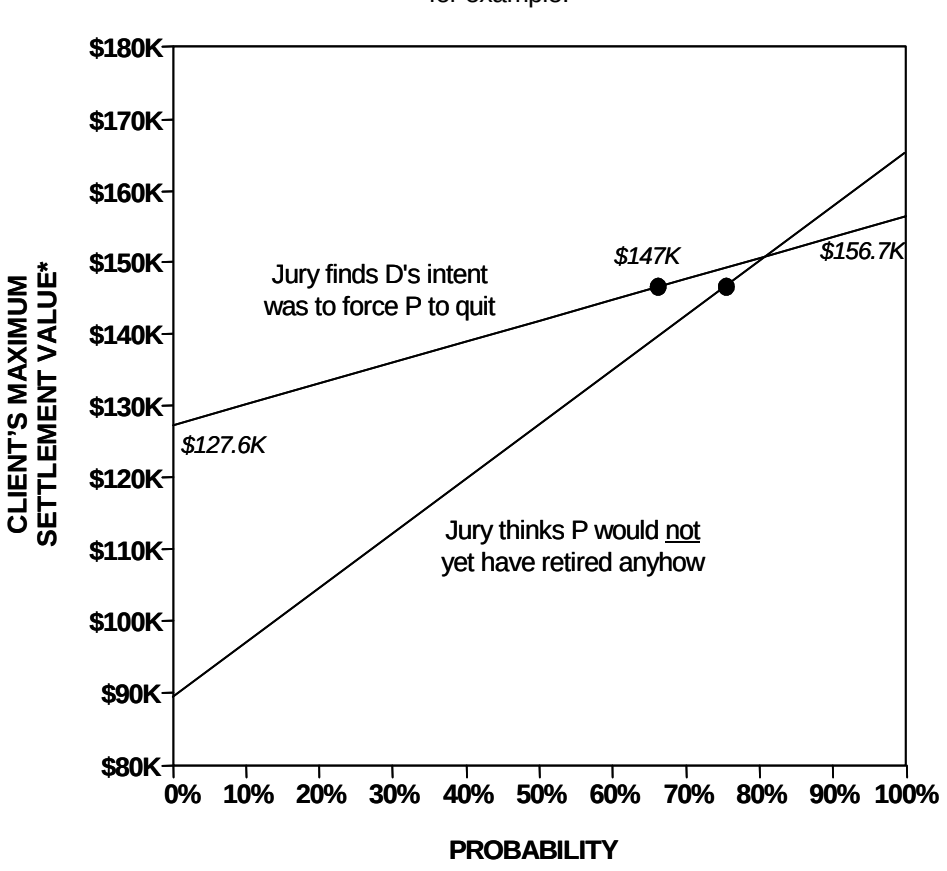
Figure 17-9 shows the results of two sensitivity analyses. These graphs are easily constructed for the "risk-neutral" client who makes decisions based on expected values. For example, to determine the dollar value at which the top graph ("Jury finds D's intent was to force P to quit") should intersect the left axis ("Client's Maximum Settlement Value"), first set the probability on this issue to 0 percent (.00) in **Figure 17-6** (the original decision tree for the liability issues); it was .67. Then repeat the arithmetic described in **§ 17.3**, using .00 instead of .67. Obviously, because anything times zero is zero, the top two scenarios will now have a probability of 0 percent. The third one will have a probability of 20 percent, because when the probability is changed to .00 for "Jury finds D's intent was to force P to quit," it must simultaneously be changed to 1.00 for "Was not intent," and .80 times .25 times 1.00 equals .20 or 20 percent. The probabilities of the remaining scenarios are unaffected by the change on the "Was the intent" issue. Thus the revised probability of "D Wins" would be 0 percent plus 20 percent plus 12 percent plus 20 percent, equals 52 percent.

If 52 percent is then used in **Figure 17-7** instead of 40 percent, the probability-weighted average that was previously calculated (see **§ 17.3**) as $147,000 would be recalculated as $127,600. This determines the point of intersection for the left axis of the sensitivity analysis graph for this issue.

[6] Although **§§ 17.4** through **17.13** reflect the experiences of many attorneys who have been through my seminars, I am particularly grateful to five for sharing their comments and experiences with me: Bill Jones (General Solicitor, AT&T), Jay Lapin (Wilmer, Cutler & Pickering), Stuart Parsons (Quarles & Brady), Tom Stanton, (Reinhart, Boerner, Van Deuren, Norris & Rieselbach, and former General Counsel, Kimberly-Clark Corp.), and Dick Von Wald (General Counsel, Johns Manville Corp.).

Figure 17-9.

SENSITIVITY ANALYSIS GRAPHS FOCUS ATTENTION ON UNCERTAINTIES THAT REALLY MATTER



**i.e., "expected value," if client is risk-neutral*

The point of intersection for the right axis would be similarly calculated, but by first substituting a probability of 1.00 for .67 in **Figure 17-6**. This would produce probabilities of 18 percent, 2 percent, 0 percent, 48 percent, 12 percent, and 20 percent for the six scenarios of **Figure 17-6**. The overall probability of "D Wins" would then be 34 percent, resulting in a new expected value of $156,700.

A straight line can now be drawn connecting the three expected values ($127,600, $147,000, and $156,700). This line makes it easy to see the extent to which the client's settlement value increases as the probability of losing the issue increases.[7]

It should not be assumed that the existence of an issue for which a sensitivity analysis reveals a large variation in settlement value necessarily makes early settlement impossible. For example, with reference to **Figure 17-9** and the issue of "would not yet have retired anyhow," counsel would probably be comfortable beginning negotiations if it seemed that the plaintiff might settle for $100,000 or less—especially taking into account the money saved by not doing additional discovery, and the fact that the discovery might uncover bad evidence as well as good.

Furthermore, even if a sensitivity analysis reveals a large variation in settlement value depending on the outcome of a particular issue and the issue does prove to be a "deal breaker" with respect to early *settlement*, this does not mean that early *resolution* is also impossible. In fact, such knowledge should greatly improve the chances of early resolution by pointing you toward the best ADR approach, as discussed below in **§§ 17.14** and **17.15**.

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[7] *See* Victor, *The Proper Use of Decision Analysis to Assist Litigation Strategy*, 40 Bus. Law. 617, 627 (1984). If necessary, joint sensitivity analyses showing the combined impact of varying probabilities on two or more issues simultaneously can also be easily performed and graphed.

§ 17.6 Greater Confidence

Even if counsel is willing to think about settlement without performing a decision tree analysis, counsel will usually feel much more confident in the quality of his or her recommendations once a Litigation Risk Analysis is undertaken. The risk analysis makes most attorneys think harder about what issues the trier will find important. It also makes them focus more clearly on how these issues are interrelated, and assess more realistically the odds of prevailing on each issue. And perhaps most important, risk analysis allows counsel to use logic rather than sloppy guesswork to combine the many subjective judgments required by the case (see the earlier discussion of **Figure 17-5** in **§ 17.3**), and to explore correctly the consequences of making alternative assumptions.

§ 17.7 Consensus Is Easier

Usually there are many players that make up "our side": several attorneys both in the firm and in the corporate law department, the client's personnel who were involved in the problem before it became a lawsuit, and the executive or group of executives who must now make the ultimate case strategy decisions. It should not be surprising, therefore, that "our side" often has difficulty reaching agreement on the dollar value to be placed on litigating if it lacks a way of clearly illustrating and rationally supporting any valuation. This is especially true early in a case when complexity and uncertainty, disorganization, and confusion may be at their greatest. As a result, "our side" may not have the confidence to enter into settlement talks or any other dispute resolution process. This lack of confidence on the part of either the team of counsel or the client is one of the major stumbling blocks to early, non-litigated resolutions. It is easily removed, however, by creating the clear, comprehensive picture of the case that results from a risk analysis and that demonstrates to co-counsel and the client a well-reasoned recommendation. This is especially helpful if client emotions are running high and clouding the ability to evaluate the case rationally. One look at the decision tree should help to get the client in the right frame of mind—focused on the merits of the case—and prevent an emotional, knee-jerk reaction.

§ 17.8 Persuading the Adversary Is Easier

If the Litigation Risk Analysis produces the kind of clear thinking that allows *our* side to understand the issues and the risks posed by proceeding to trial, then it should also be effective in persuasively explaining that view of the case to the *other* side. Many attorneys have reported success in using decision trees to educate their opponents and quickly settle their lawsuits.

This is not to suggest that counsel necessarily disclose everything to the opponent. As in all settlement negotiations, premature disclosure of arguments the other side might not have considered could weaken one's position. But if one party really wants to settle and feels that the opponent is likely to perceive the critical issues on its own in a timely fashion, discussing the analysis in detail should pose little risk. It is also possible to try what one corporate counsel has found successful in some situations: Give the adversary a decision tree showing the obvious liability and damages issues, ask him or her to fill in the probabilities (without disclosing yours), and solve for the expected value. It may turn out to be just a fraction of what was being demanded!

§ 17.9 Settlement Is More Likely

The very use of decision trees and probabilities should create an environment conducive to dispute resolution. A decision tree is an immediate acknowledgment to the adversary that counsel recognizes that not all scenarios in the case conclude in a total victory—or defeat. Similarly, using probabilities (which most lawyers are reluctant ever to set above 90 percent) shows recognition that litigation has no sure things but instead contains risks and uncertainties. In addition, these techniques convey to the adversary that counsel is being as serious and rigorous as possible in evaluating the risks of litigation. Attorneys who have shared these analyses with the other side have found an increased attentiveness on the part of their opponents.

Last, negotiations are less likely to come to a standstill in the event one party demands far more than the other side offers. Instead, the nature of a good decision tree analysis should force discussion to the level of the individual issues, influencing factors, and probabilities rather than the overall value of the case. Counsel may find many issues on which they are in close agreement and only a few on which they really differ. At that point, they may be surprised to find that if they each use their own probabilities and each perform the simple arithmetic discussed earlier in **§ 17.3**, the values they arrive at are not far apart.

It is easy to disagree on the overall chance of winning if the issues are described only qualitatively (see **Figure 17.5**). Many apparent disputes over settlement values are just that—apparent, not real. Discussing the merits issue by issue, in numerical probabilities, helps to define real differences and thus disclose true settlement potential.

§ 17.10 Balanced Perspective

Creating the decision trees and especially the list of reasons why each of the issues could be resolved favorably or unfavorably (as discussed in **§ 17.2**) offers the ideal tool for educating the attorney. The more explicit the analysis, the easier it is for the adversary to identify important omissions in counsel's thinking. This, in turn, may save counsel from some very costly mistakes; for example, turning down a settlement which seemed to be too high, only to find out after costly discovery (or far worse, after losing at trial) that one's own weaknesses had been overlooked.

At the same time, by being explicit in the risk analysis, counsel also reduces the chances of being oversold by the adversary; that is, overreacting to new information which the opponent presents. Psychologists have repeatedly found that such overreacting is a common experience.[8] The lists developed in step two of the risk analysis should prevent counsel from placing too much weight on the new information, because they force counsel to recall the *full* set of reasons that were identified on each side of the issue.

§ 17.11 Using a Sensitivity Analysis

Performing the risk analysis and the sensitivity analyses described in **§ 17.5** offers a real bargaining advantage in settlement talks over a less well-prepared adversary. Remember that these sensitivity analyses identify the issues with the biggest impact on the case value and about which, therefore, it is most important to convince the other side. For example, **Figure 17-9** illustrates that the question of "whether or not P would have retired anyhow" is more important than "whether D's intent was to force P to quit"—because similar changes in probability cause

[8] Tversky & Kahneman, *Judgment under Uncertainty: Heuristics and Biases*, 185 Science 1124 (Sept. 1974).

a bigger swing in the client's expected value for the former issue. Therefore, it is possible to concede a little to the adversary on the latter probability if it provides an advantage on the former!

§ 17.12 Taking the Opponent's Perspective

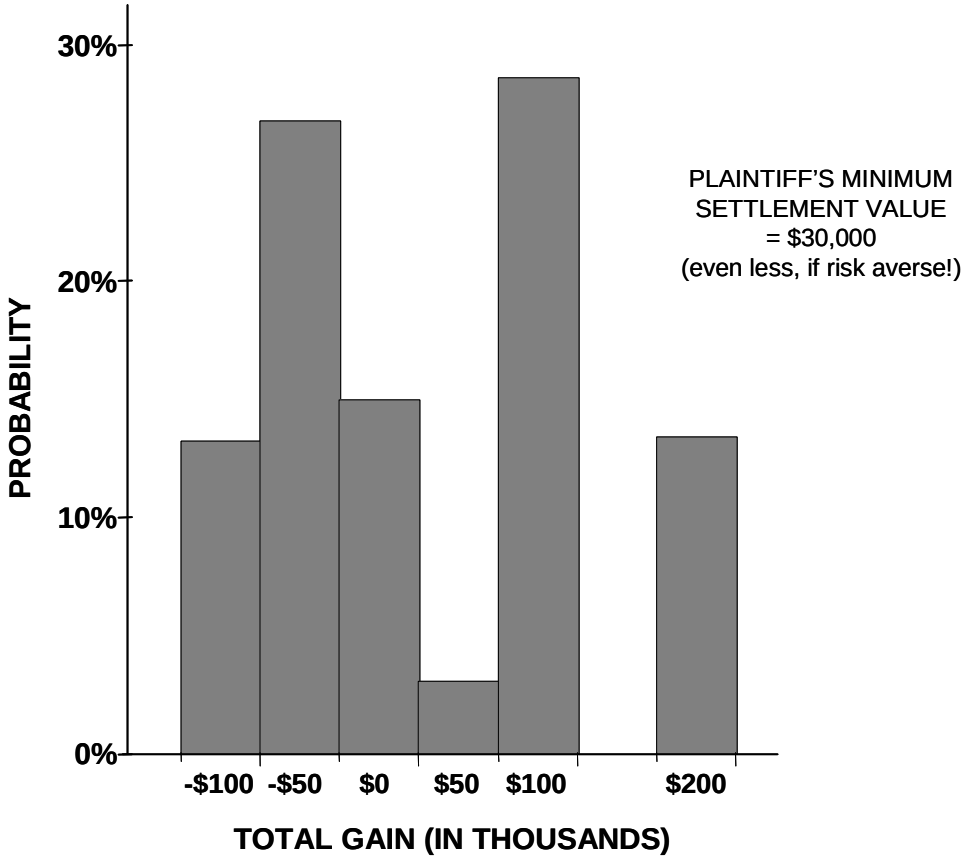
One may derive a bargaining advantage by repeating the original analysis from the opponent's perspective before the first negotiating session (see **Figure 17-10** on the following page). This usually helps counsel understand better how legal fees for both sides impact the parties' valuation of the litigation alternative. Then, drawing the plaintiff's overall probability distribution (see **Figure 17-11**) and thinking about how risk averse he or she may be, should also produce insights that can help the parties arrive at a more favorable resolution of the dispute.[9]

§ 17.13 Persuading the Judge

A Litigation Risk Analysis has proven a most effective means of educating the settlement conference judge: it shows how reasoned and rigorous the attorney has been in the analysis, and can get the judge (in the words of one attorney who has had this experience) "to beat on the other side."

Figure 17-11.

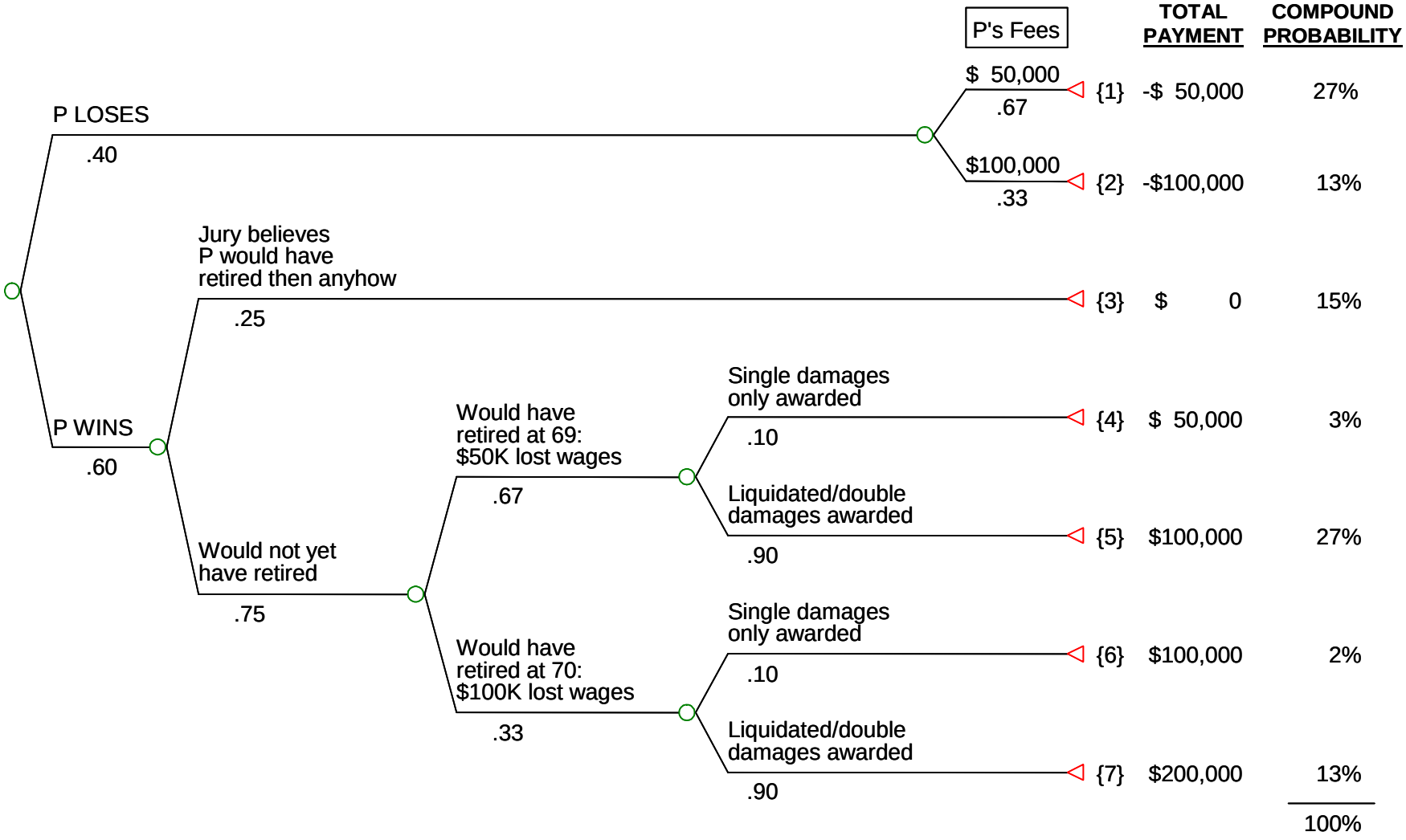
REPEATING ANLAYSIS FROM ADVERSARY'S VIEW MAY PRODUCE VALUABLE INSIGHTS



[9] **Figure 17-11** (as well as **Figure 17-10**) is appropriate for a case which is *not* being handled on a contingent fee basis. If the plaintiff were paying counsel a contingent fee, it would be most insightful for defense counsel to prepare two sets of figures—one showing the plaintiff's risks and potential recoveries and one showing the attorney's.

Figure 17-10.

REPEATING ANALYSIS FROM ADVERSARY'S VIEW MAY PRODUCE VALUABLE INSIGHTS



RISK ANALYSIS AND ADR

§ 17.14 Scope of ADR Can Be Limited

If settlement is not possible and ADR is being considered, the parties can use the issue-by-issue, probability-by-probability focus of the decision tree from their unsuccessful settlement negotiations to greatly limit the scope of the ADR. That is, face-to-face negotiations might at least have produced agreement on the issues belonging in the tree and the probabilities of many of them. ADR could then be limited to just those issues for which probabilities were substantially different and for which the differences caused a significant variation in expected values. This would reduce the costs of ADR and avoid a lopsided decision.

§ 17.15 Focus on Important Issues

Many forms of ADR are highly compressed as compared to trial. With limits on the total amount of time available, both before and during the process, and on the number of witnesses and types of evidence that can be presented, an enormous premium exists for identifying quickly those few issues and arguments that should be stressed. Sensitivity analyses are the most reasoned way for making such determinations.

§ 17.16 Nonbinding ADR Results

In nonbinding ADR, the danger exists—because of the tendency to overreact to the latest information (see **§ 17.10**)—that counsel will give too much weight, when rethinking the value of the case, to the conclusions reached by the neutral third party. Given all of the potential advantages of nonbinding ADR, it is wise to be cognizant of this one danger so you can protect against it. The best way to do this is to conduct a thorough risk analysis ahead of time (with an emphasis on listing all the reasons for an *unfavorable* result on each of the issues, as discussed in **§ 17.2**), and to think about just how surprised you would really be by various findings of the neutral. In doing so, remember that statisticians, "jury scientists," and others who try to predict the outcome of some event based on the results of a survey give very little weight to a *single* observation.

§ 17.17 Updating Settlement Position

As discussed in **§ 17.1**, nonbinding ADR may be a cost-effective way of getting more information about the strengths and weaknesses of your case. This information should then be used by counsel and client to better assess the risks of litigation and arrive at a reasonable settlement position. If a decision tree analysis is performed prior to the nonbinding ADR, it requires little effort to subsequently revise the analysis to reflect what has been learned in the ADR proceeding.

§ 17.18 Choosing between Litigation and ADR

If binding ADR is being contemplated, many of the problems that prevent early negotiated settlement may also keep counsel and/or the client from deciding to commit to binding ADR, especially at an early enough stage to have a significant cost-savings potential. These problems—analyzing numerous uncertainties and presenting a convincing recommendation to the client—are discussed in **§§ 17.4** through **17.7**. But in the same way that the exercise of performing a *litigation* risk analysis permits the attorney to formulate a settlement strategy, a similar risk analysis *of the ADR* can be performed to facilitate agreement on whether it is preferred to litigation or not. This entails reassessing all of the probabilities and dollar amounts in **Figures 17-6** and **17-7** to reflect the different trier, information, length and nature of the presentations, and costs inherent in the ADR proceedings as compared to a trial after full discovery.

For example, one might expect an arbitrator in the hypothetical constructive discharge case to be more favorable to the employer (than would a jury) on the issues of whether the conditions under which P was made to work were intolerable and whether D's actions were age-related. On the other hand, it is possible that an arbitrator is even more likely than the judge to feel that D need not have intended for P to quit in response to the demotion in order to be found liable. Also, one might reason that the ADR process will make it more difficult to develop evidence that P was planning to retire anyhow, or would have retired at 69 rather than 70. In light of such conclusions, would the overall risks of arbitrating be more or less than those of litigation? **Figures 17-12** and **17-13** show the revised probabilities and costs. A calculation of the expected value of *arbitration* produces $100,000 as compared to the expected value of *litigation* of $147,000 (see **§ 17.3**). The decision to commit to the arbitration is now an easy one to make, as a result of having performed the two risk analyses.

Figure 17-12.

REEVALUATING RISKS TO SHOW DESIRABILITY OF ADR IS EASY

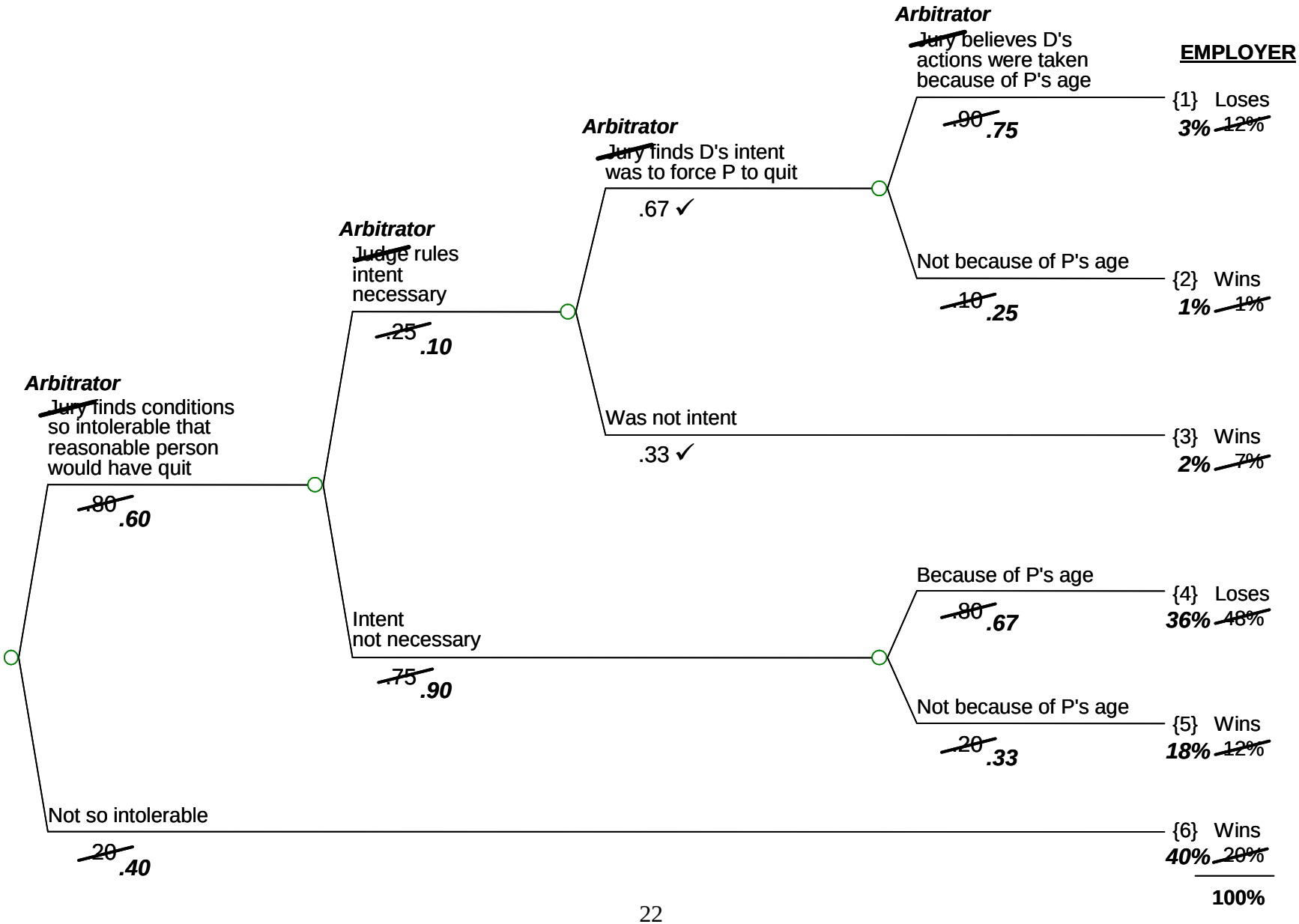


Figure 17-13.

REEVALUATING RISKS TO SHOW DESIRABILITY OF ADR IS EASY