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Making Good Decisions in Mediation

Decision Analysis Helps Your Client Evaluate Settlement Options

Imagine these two scenarios:

Scenario 1. A plaintiff's lawyer represents a client who is suing her employer for sexual harassment. At mediation, the lawyer makes an initial demand of $500,000. This number reflects the lawyer's assessment of his client's best-case scenario. In private, the lawyer discusses with his client the risks and uncertainties of litigation and the possible outcomes if the case goes to trial. He tells his client that she has a "good" chance at winning on liability and a "pretty good" chance at collecting a "six figure" damage award.

Scenario 2. A defense lawyer represents a corporate client who is being sued by another company for breach of contract. At mediation, the plaintiff's initial demand is $750,000. The defense lawyer tells her client that she believes the client will "probably lose" on liability, but that she doesn't think that plaintiff could collect "anything near" $750,000.

Have these lawyers clearly explained to their clients the potential upsides and downsides of their cases? No, they have not.

As lawyers, we often use words to describe potential outcomes of litigation. But since words alone can be interpreted in a wide variety of ways, this approach can often lead to real misunderstanding. For example, I asked three people to explain in a percentage what a "pretty good chance" of winning means to them. Not surprisingly, I got three different responses: 40%, 60% and 75%.

In order to make sound, appropriate decisions about whether to settle or go to trial, clients need clear information that is not susceptible to that kind of potential misunderstanding.

And this is where decision analysis can be very useful.

What is Decision Analysis?

Decision analysis, also known as litigation risk analysis, can help clients evaluate multiple uncertainties in a lawsuit, thereby helping them make better decisions about whether or not to settle a case.

Decision analysis boils down to the following three steps:

1. Determine the possible outcomes of the lawsuit and the likelihood of their occurrence;

2. Determine the net cost or net gain with respect to each outcome; and

3. Determine whether non-monetary factors are influencing your client's decision.

A decision tree is a simple visual way to depict this process. So let's build a sample decision tree to see how this process works, step by step. For those who have math phobia – fear not! A decision tree only requires basic arithmetic and can be easily performed with some paper and a calculator.

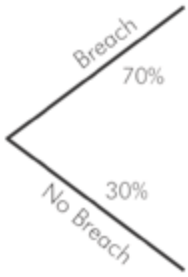
Sample Decision Tree: Breach of Contract Case

Let's assume by way of example that you are representing a client who is being sued for breach of contract.

Step 1: Determine the possible outcomes and the likelihood of their occurrence.

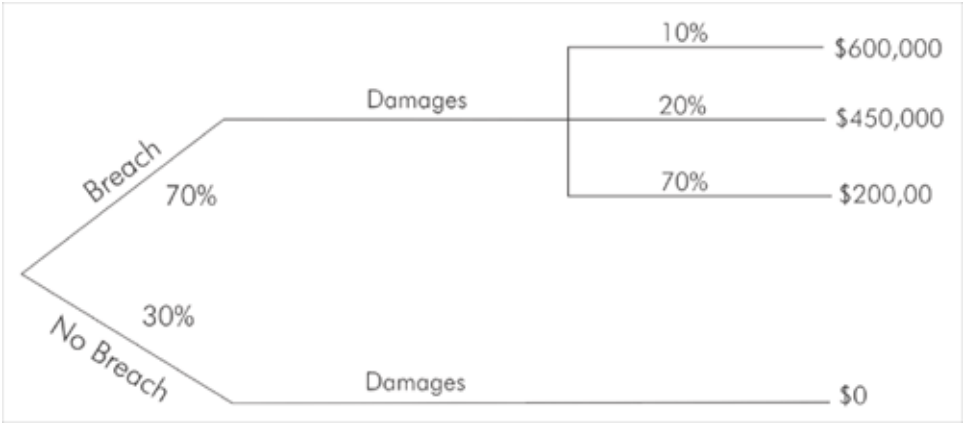
You begin the process by asking two pivotal questions: F*irst*, what are the chances of winning and the chances of losing on liability? And *second*, if your client loses, what damage amount would be awarded and what is the likelihood of this occurring?

In this case, you estimate that there is a 70% chance that a trier of fact will determine the contract was breached, and a 30% chance that a trier of fact will determine no breach occurred. You note the probabilities on the tree's branches.



You then continue the tree from the breach branch to identify the next uncertain event: damages. Your evaluation considers the merits of plaintiff's claim for actual as well as consequential damages.

You may decide that if damages are awarded, there are a variety of possible outcomes. If so, it is useful to organize them into ranges. For example, you might evaluate the damage range to be $200,000 (low), $450,000 (medium) to $600,000 (high). You then draw these three potential outcomes on the damage branch. Finally, you assign probabilities to these three outcomes, based on the strength of plaintiff's damage claims. In this case, you believe that plaintiff's claim for actual damages is strong but the claim for consequential damages is weak. You decide the probabilities as follows: a 70% chance for $200,000, a 20% chance for $450,000 and a 10% chance for $600,000.



You have now completed the tree. Remember, decision analysis is only as good as the estimates you use, so it's important to make the most realistic estimates you can.

The next step is to evaluate the outcomes.

Step 2: Determine the Net Costs Or Net Gains To Your Client.

To evaluate the outcomes, you multiply the possible outcomes of each event by their probability of occurring. (For example, the value of the high range if a breach occurs would be 70% x 10% x 600,000 = $42,000.)

You then add the products of each potential outcome:

Low Range		Medium Range		High Range	
(.70 x .70 x 200,000)	+	(.70 x .20 x 450,000)	+	(.70 x .10 x 600,000)	
$98,000	+	63,000	+	42,000	= $203,000

The $203,000 figure is sometimes called the expected value, or from the litigator's perspective, the average amount that a trier of fact would award.

Next, you estimate the cost of litigation, including attorneys' fees. Let's assume you estimate these costs to be $70,000. This amount should be added so that the client has a complete picture of the net result.

Average Damage Award		Estimated Attorneys Fees and Costs		Total Average Costs
$203,000	+	$70,000	=	$273,000

The amount of $273,000 can be characterized as the total average costs for the defendant to take the case through trial. Clearly, decision analysis does not guarantee what will happen at trial. It does, however, provide a single number that your client can use to compare the potential costs of trial with your current settlement position.

If you do not want to reduce the possible outcomes of trial to a single number, then you need not take this final step. You would simply diagram the tree, as outlined above, with the range of possible outcomes on liability and damages. This, by itself, can help your client evaluate settlement options by comparing them with the potential consequences of trial.

Step 3: Determine Whether Non-Monetary Factors Are Influencing Your Client's Decision.

Decision analysis can be used to evaluate the non-monetary factors such as time, emotions and attitude toward risk. When helping your client evaluate settlement options, it's important to explore these intangible factors, because they may affect your client's settlement range.

You can quantify these intangible factors and add them to the decision tree using the analysis described above. But it's often just as useful for your client simply to identify these intangible factors and then determine whether or not they should play a role in increasing or decreasing his settlement position.

Decision Analysis Brings Welcome Clarity

Taken together, the three steps of decision analysis help quantify the key factors, both monetary and non-monetary, that govern good decision-making. It brings welcome clarity to a process that is inherently uncertain, and is therefore an invaluable tool for you and your client.