

Litigation Risk Management and Alternative Dispute Resolution

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Litigation Risk Management

Litigation Risk Management, is the application of decision and risk analysis techniques to litigation decisions: decisions such as whether or not to settle a suit and for how much; how much and where to spend on discovery; which legal issues warrant the most precedential research; and how much should be spent on each. The essential features of a litigation analysis are the development of a decision tree and the encoding of the probabilities that reflect counsel's best judgment as to the likelihood of the possible outcomes. Developing the decision tree and assessing the probabilities is critical to a proper analysis. The results are presented as a probability distribution of the possible net monetary outcomes to the client. The expected or average value of this distribution is a sound basis for settlement negotiations, as it is a very good measure of the value of the case to the client, a value which can also include indirect business consequences of litigation, such as adverse publicity and a subsequent adverse impact on sales.

Thinking Through The Case

Although the obvious products of the analysis are numbers and the decision tree, the real value, according to almost every attorney who uses Litigation Analysis on a regular basis, is that it forces a thinking through of the case that gives both new and valuable insights into the critical issues and how they are affected by discovery and trial strategy. The process fosters a justified feeling of comfort and satisfaction with the preferred decisions and provides a way of communicating unambiguously with the client the rationale behind these decisions.

Litigation Analysis And ADR

There are several articles that describe Litigation Analysis in more depth¹. Generally, for pedagogical reasons, they address simple cases and cannot easily demonstrate the insights and understandings that are to be had from a good Litigation Analysis. This article will specifically discuss how Litigation Analysis can benefit Alternative Dispute Resolution activities.

ADR techniques and processes are classified by stages of intervention: dispute anticipation and prevention, dispute management, and dispute resolution². Typically, Litigation Analysis is classified as a tool for dispute management, since it is useful for assuring optimum utilization of resources for pretrial discovery and research; for setting trial strategy; for promoting clear communication between counsel and client; and for getting better litigation cost estimates. However, Litigation Risk Management Analysis can play a valuable role in the third category,

dispute resolution, as well. In particular, it can be an effective tool in negotiation, mediation, and arbitration.

Negotiation

In a general model of the dispute resolution/negotiation process, each side starts with the facts and legal issues as it perceives them. However the inherent uncertainties in both the facts and possible legal ramifications are usually not acknowledged or considered explicitly. A negotiating strategy is developed, although not necessarily well grounded on the facts and legal issues. For example, the plaintiff in a case may feel that he has been wronged and insist that restitution be made when the facts and legal issues do not warrant the expected legal costs to go to trial. Similarly, a defendant may feel that he has done nothing wrong and take a hard negotiating position which may lead to very unfavorable outcomes in court. What both are missing is an explicit understanding of the consequences of the perceived facts and legal issues. A Litigation Risk Management Analysis would provide just such an understanding through a logical, comprehensive analysis that explicitly considers the available facts, the pertinent legal issues, and the uncertainties inherent in the entire judicial process. The probability of both the risks and benefits would be evident and provide a sound basis for choosing an intelligent negotiating position.

Emotional Issues

A realistic assessment of the potential outcomes of the case can help moderate and circumvent the natural emotional impulses that are usually present in disputes. It provides a clear understanding of the real risks and values of the case, independent of the negotiating position, which all too often takes on a reality of its own. The parties involved can then focus on the legal, factual and financial issues at hand rather than the emotional, "I'm right; you're wrong!" issues. In many disputes, the cost of continuing litigation is significant relative to the possible damage awards. In these cases, a Litigation Risk Management Analysis will usually reveal a zone of agreement in which a settlement leaves both sides better off than if the litigation process were completed. Anything that encourages a more rational state of mind on both sides of a dispute will lead to earlier, more reasonable and more equitable settlements.

Potential Risks

Another issue that is addressed by Litigation Risk Management Analysis is the problem of making a distinction between decisions and outcomes. Decisions are things over which one has control; outcomes cannot be controlled. One may be able to influence the likelihood of outcomes, which is the purpose of good decision making, but there is no way to have absolute control over them. The explicit acknowledgment of the uncertainty in the outcome of any judicial proceeding is usually a prerequisite to a willingness to settle. A process which promotes each side's understanding of the potential risks will, along with increasing the comfort and understanding of their positions, inherently facilitates the dispute resolution process.

Avoiding Fruitless Negotiations

Although negotiated settlements are far less costly in legal fees and management time than full court proceedings, the negotiations themselves can be time consuming and costly. Litigation Risk Management Analysis gives the parties a

way of determining whether their counterparts are serious about settling or just taking a hard negotiating position. Preliminary discussions with simple, non-revealing trees will soon show whether the opposition has a reasoned basis for its position. In this case, those issues that are causing the differences can begin to be addressed. Or, if they are negotiating without a rational basis, time and effort can be saved by avoiding fruitless negotiations, and the case can be taken to court rather than accepting what a careful analysis shows to be an unreasonable settlement.

Mediation

The role of Litigation Risk Management Analysis is similar in both mediation and negotiation although generally the mediator's use of Litigation Risk Management Analysis is more effective than the participants'. In either case, the primary factors that drive both sides to settlement are the risks and uncertainties of trial and the certain costs of the completion of the litigation process. While it clearly benefits each side to have a complete understanding of the risks and average value of its case as a basis for negotiation, there are inherent risks in revealing this assessment even to a neutral third party. If the mediator uses these assessments to suggest possible settlement values, it would clearly be in each side's interest to "game" the process by submitting optimistic assessments of its case.

On the other hand, a Litigation Risk Management Analysis by the mediator, without either side revealing what it considers to be proprietary information, is of considerable use in defining the risks of going to court for each side. If this analysis is performed properly, it will invariably show both sides that the risks of continuing the litigation process are greater than they had originally thought, and this is one of the primary functions of mediation: to motivate both sides to settle.

Arbitration

The role of Litigation Risk Management Analysis in arbitration is not so much to project or understand the range of possible outcomes should the matter proceed to trial, but to examine the potential consequences of the actions of either side in the dispute. Damage claims almost always have several critical assumptions about what would have happened had the defendant not acted as alleged. Invariably, these assumptions are uncertain. A neutral, explicit evaluation of these assumptions which takes their uncertainties into account is fairer than an evaluation that somewhat arbitrarily picks a particular scenario. There are also techniques that are beyond the scope of this paper³ that can be used to measure the relative desirability or undesirability of any of the monetary and non-monetary outcomes of the arbitration for each side. These techniques, based on utility theory, combined with a probabilistic analysis of the consequences of the action in question can lead to an optimally fair, understandable resolution of a dispute that leaves both sides equally satisfied (or dissatisfied).

Difficulties And Issues Not Addressed

There are, however, some problems with using Litigation Risk Management Analysis to promote settlement. If the antagonists are not sophisticated, the use of these techniques will not be understood and be of little benefit. In addition there is a general perception that numbers imply certainty and precision, while the purpose of Litigation Risk Management Analysis is just the opposite, to convey risk and uncertainty. The numbers are used because they are unambiguous, not because

they are precise. Saying there is a 20% chance that the plaintiff could lose the suit doesn't mean that the chances are 20.00% and not 21.5% but that there is about one chance in five. This is much clearer than saying "There is some chance that the plaintiff could lose, not large but not small either." Finally, the use of numbers and rational analysis may not influence that other important part of the dispute resolution process, human nature. It is hard to boost egos, provide vindication, or salve wounded pride with numbers, and thus the use of Litigation Risk Management Analysis is necessarily a less fluid approach in terms of the human dynamic.

Another problem with the general nature of the dispute resolution process that Litigation Risk Management Analysis does not address is how to get the involved parties to analyze or think about their cases earlier in the process. The delay until the steps of the courthouse is invariably expensive and to no one's best interest.

A Systematic, Explicit Process

Finally, although most participants in dispute resolution do go through a process similar to Litigation Risk Management Analysis, it is not explicit, nor is it systematic and it can be demonstrated that almost everyone has systematic biases in thinking about uncertainties and that one must go through a formal(not necessarily elaborate or complicated) process to best mitigate the effects of these biases.

Litigation Risk Management Analysis, when properly applied can be a powerful tool to promote rational resolution of disputes. Its most important feature in dispute resolution is making explicit the risks inherent in litigation, risks which are almost invariably greater than those initially perceived by intuition alone. While not a panacea, it is certainly useful in more areas of ADR than has previously been acknowledged.

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