By Kathy Perkins

Settlement Savvy

It's three months to trial and you're evaluating the latest demand from the plaintiff. The motion for summary judgment was denied so if there is no settlement, the case will be tried. You've assembled a lot of data from outside counsel: the range of possible verdicts and likelihood of outcomes within that range; attorneys' fees; out-of-pocket costs; jury information; the proclivities of the judge; and the friendliness of the appellate court. Added to that list is the impact of a verdict on the company, publicity, precedent, transactional time—yours and company witnesses—and timing. How can you get the best possible deal from the other side? Is that better than going to trial? Why did you think going in-house would be easier than the life of the law firm litigator? Where can you find a completely clear crystal ball?

A fascinating study of 2,054 California civil cases decided between 2002 and 2005 provides a sobering report about the quality of settlement decision making. Randall L. Kiser, Martin A. Asher, and Blakeley B. McShane, *Let's Not Make a Deal: An Empirical Study of Decision Making in Unsuccessful Settlement Negotiations*, 5 J. Empirical Legal Stud. 551, 551–591 (Sept. 2008), http://www3.interscience.wiley.com/cgi-bin/fulltext/121400491/PDFSTART. The study, which also reviewed other studies in multiple jurisdictions and found consistent results, raises provocative questions about how lawyers and clients make decisions about settling versus going to trial.

The purpose of the study was to determine whether, and under what circumstances, the parties did better at trial than if they had settled. If not, how much did it cost a party to proceed to trial rather than to accept the last settlement offer from the defendant or demand from the plaintiff? As described below, the researchers reported a high incidence of "decision error," defined as when a party's position after trial or arbitration was the same or worse than the rejected offer—otherwise known as the "oops" phenomenon. To determine and quantify decision error, a party's additional attorneys' fees after the settlement discussions failed were taken into account *only* to the extent that they were awarded to a prevailing party.

Results of Study

Overview

In only 15 percent of cases did both parties better their last settlement positions by going to trial. For example, assume that the last offer from the defendant was $400,000 and the lowest demand from the plaintiff was $1,000,000. The jury returned a verdict of $650,000. Setting aside costs and fees for the moment, the defendant bettered its last settlement opportunity by $350,000 and the plaintiff by $250,000. Assuming monetary and non-monetary transactional costs—costs, fees, value of time related to trial and appeal—did not wipe out the benefit, both sides were better off with the trial outcome than if they had taken the last deal on the table.

Overall, plaintiffs made a decision error in 61.2 percent of cases at an average cost of $43,000. Defendants fared better at trial more often than plaintiffs—with decision error only 24.3 percent of the time—but the cost of being wrong was much greater, averaging $1.14 million.

The study reveals that a number of factors can lead to more frequent or costly decision errors, which suggest ways to strategize settlement with more savvy and to improve confidence that the last settlement proposal from the other side is the best deal possible. The researchers evaluated decision error based on a number of variables described in the next section. Cases were only included if information was available about each parties' last settlement position. The study did not include class actions or a few other types of cases in which too many variables existed to draw conclusions about the settlement offers and trial results.

Offers of Judgment

The factor that showed the greatest impact on decision error was offers of judgment. This study focused on California Code of Civil Procedure Section 998, that state's counterpart to Federal Rule of Civil Procedure Rule 68. The purpose of an offer of judgment is to encourage the settlement of lawsuits before trial by penalizing a party who fails to accept a reasonable offer from the other party. Rule 68 permits a party to serve an offer to the opposing party to allow judgment to be taken against that party with costs then accrued. If the offer is not accepted within 10 days and the ultimate judgment against the party making the offer ultimately is "not more favorable" than the offer, the opposing party must pay the costs accrued after the offer was made.

Kisher, Asher, and McShane's study found that when a plaintiff or defendant made an offer of judgment, that party's decision-error rate and cost decreased, with a corresponding increase in both for the non-offering party. A plaintiff-only offer improved the decision-error rate from 61 percent to 41 percent for plaintiffs. Defendants reduced their odds of decision error with an offer of judgment to plaintiffs from 22 percent to seven percent. When both parties made offers of judgment, there was less deviation in the error rate compared with the "no offer" decision-error rate. However, there was a striking decrease in the average cost of error for defendants—from $1.3 million

■ Kathy Perkins started her own workplace law and mediation firm, Kathy Perkins LLC, in Lawrence, Kansas, in March 2008, after 25 years of law firm litigation practice, most recently with Constangy, Brooks & Smith LLP, where she is still of counsel. Ms. Perkins is an executive committee member of the Management Labor & Employment Roundtable and on the board of the Heartland Mediators Association.

without offers to $300,000 regardless of whether offers were made by defendants or plaintiffs.

Interestingly, although the purpose of an offer of judgment is to encourage settlements, the researchers opine that this technique may actually induce risk-taking by parties and, paradoxically, provoke the gambling mentality that it is intended to curb. One question that Kisher, Asher, and McShane's study raises is whether a statutory offer of judgment actually heightens risk-seeking behavior by the receiving party. The researchers compared 998 offers to "loser pays" systems, evaluated by Jeffrey Rachlinski, which found that "by raising the stakes at trial, the loser-pays system makes litigation itself more valuable and can discourage settlement." Kisher, Asher, and McShane, at 575 (quoting Jeffrey Rachilinski, *Gains, Losses and the Psychology of Litigation* 70 S. Cal. L. Rev. 113 (1996)).

Type of Case, Fee Arrangements and Insurance

Cases were categorized by Kisher, Asher, and McShane as contract (including real estate), employment, fraud, intentional tort, medical malpractice, personal injury, premises liability, eminent domain, product liability, and negligence (other than personal injury). The table on page 25 summarizes some of the researchers' findings by type of case. *Id.* at 578.

Plaintiffs' decision-error rates exceeded their overall mean of 61 percent in cases involving negligence, premises liability, intentional tort, product liability, and medical malpractice. Their decision-error cost was highest in contract cases—$144,900—followed closely by fraud at $134,400.

Defendants, on the other hand, had the highest decision-error rates in employment, fraud, contract, and eminent domain cases. In every single type of case, defendants' mean cost of error vastly exceeded that of plaintiffs. The high was $4.1 million in fraud cases, and only in cases of eminent domain, personal injury, intentional tort and medical malpractice was the cost of error below a million dollars.

The researchers observed that plaintiffs had higher decision-error rates in the types of cases in which contingency fee arrangements are common, such as product liability, premises liability and medical malpractice cases. On the defense side, decision-error rates were highest in cases in which insurance coverage is generally not available, such as contract or fraud. They noted an inverse relationship between plaintiff decision-error and win rates; that is, high decision error in cases with historically low win rates, such as medical malpractice and product liability. The opposite was true for defendants: their highest decision-error rates were in cases with high win rates for plaintiffs, *e.g.*, contract and fraud.

In every single type of case, defendants' mean cost of error vastly exceeded that of plaintiffs.

Who's Your Lawyer?

The study identified the following for attorneys representing the parties: gender, firm size, years of experience, the academic and diversity rank of their law school, and whether they were trained as a mediator. The only significant identity-related factor was attorney-mediator. Both plaintiffs and defendants represented by an attorney with mediation training had somewhat lower decision-error rates than those who were not. In personal injury cases—the largest sample available—plaintiffs' decision error dropped from 53 percent to 45 percent and defendants' from 26 percent to 17 percent.

Forum

When decision error was evaluated based on the forum, remarkable differences emerged among jury trials, bench trials, and arbitration. Because 90 percent of cases in the study were tried before a jury, those results were, of course, similar to the overall results. When cases were tried before a judge rather than a jury, defendant- and plaintiff-decision error were identical, 42.6 percent, increasing by 20 points for defendants and dropping for by 20 points for plaintiffs. In arbitrations, defendant decision error was comparable to bench trials, while for plaintiffs it dropped to 28.9 percent. But in 25.8 percent of arbitrations there was no decision error: both parties achieved a result more favorable than the last settlement offer.

Type of Damages

Cases were also classified by types of damages: current, defined as injuries and damages already sustained; future, defined as prospective losses; and punitive. The researchers were interested in whether the results would support a behavioral economics theory that a party is more likely to recover actual losses already sustained than lost future profits or other remote damages. The results, though, were inconclusive about distinctions in decision error involving claims for current or future damages or both. The most interesting conclusion was that decision-error rates were significantly affected by punitive damages claims. Defendant decision error rose by five percent when punitive damages were involved, while plaintiff decision error decreased by about 14 percent.

We're Getting Worse!

With the increasing emphasis on sophisticated risk analysis, litigants should be getting better at deciding when to hold and when to fold. But comparing Kisher, Asher, and McShane's results to other studies suggests that parties are making increasingly worse decisions about when to go to trial rather than settle. Both frequency and cost of decision error was greater in 2004 than in 1964, despite vastly greater resources and data. The study provides us with the opportunity to reflect on the reasons why cases do not settle and the costs and benefits associated with those decisions. Here are a few observations about how corporate counsel might make better settlement decisions.

Strategies for Obtaining a Realistic Settlement Evaluation

Invite the Bad News with the Good

Some clients send a message—either directly or indirectly—that they expect their lawyer to win the case. Realistic assessment of bad facts or risk of liability

leads to doubts about whether the lawyer is any good or is aggressive enough. If you're reading this article, you probably aren't that client, but it is worth taking a step back to look at the culture that has developed around your organization's relationship with outside counsel. Are you demanding and rewarding realistic analysis that includes bad news?

Seek Different Viewpoints

Most successful lawyers vet their case with seasoned practitioners to gain a balanced view. When counsel seeks only like-thinking colleagues, they tend to receive an overly optimistic view. It may be comforting in the short run but ultimately not helpful. In cases with a lot at stake, it can be cost effective to retain trial or jury consultants to run a mock trial or focus group or provide other expert advice on the facts, witnesses, and other evidence. However, even a small investment, such as hiring an attorney who typically practices on the other side of an issue—for instance, a plaintiff's employment lawyer—to review documents or listen to a summary presentation can pay off in the long run.

Is the Principle Worth Its Weight in Gold?

But it's the *principle*! Of course a party is entitled to make a decision that they'd rather lose than pay a dime to settle. If you are in-house counsel, your job is to make sure to provide your internal clients with a pragmatic assessment of what that will cost. And if you are outside counsel, your job is to provide in-house counsel with the necessary information so that he or she can provide that pragmatic assessment to his or her internal clients. We all know that settlement decisions are based on many factors other than pure economics. Extrinsic motivators—*e.g.*, desire for just conflict resolution or "vindication," support for management decisions, necessity of minimizing additional potential claims, effects of publicity, need to send a market signal—may cause parties to sacrifice the optimal economic outcome in favor of a compelling, non-economic need.

There is nothing inherently wrong with considering factors external to the risk or cost of a particular case, as long as it is clear that pursuing them may have a substantial price tag. Other benefits to a company can mitigate that loss, but it is rare that those benefits are adequately evaluated, quantified, and allocated. In-house and outside counsel will have varying degrees of influence over the ultimate decision-maker, but at the very least, they can advise and hope their client will listen.

Expand Your Horizons

The Kisher, Asher, and McShane study suggests that a variety of factors may impact the settlement decision-making process. If a company is a defendant, consider the high cost associated with erring in deciding not to settle. Even if your jurisdiction has lower verdicts than California, Kisher, Asher, and McShane's results have generally been consistent with data compiled from other jurisdictions. Have you overlooked evidence that might turn a jury against your company? Defendant decision-

Win Rates, Decision Errors, and Cost of Error

Case Type	Plaintiff Win Rate	No Error	Percentage of Error	Mean Cost of Error
Overall		14.5%		
Plaintiff			61.2%	$43,100
Defendant			24.3%	$1,140,000
Eminent Domain	100.0%	25.0%		
Plaintiff			41.7%	$72,100
Defendant			33.3%	$523,600
Contract	62.6%	11.5%		
Plaintiff			44.3%	$144,900
Defendant			44.3%	$1,528,700
Fraud	61.4%	12.3%		
Plaintiff			47.4%	$134,400
Defendant			40.4%	$4,086,200
Personal Injury	60.9%	20.5%		
Plaintiff			53.2%	$32,200
Defendant			26.3%	$622,000
Employment	51.1%	16.5%		
Plaintiff			51.1%	$64,800
Defendant			32.4%	$1,417,700
Negligence (non PI)	42.6%	14.9%		
Plaintiff			66.0%	$82,100
Defendant			19.1%	$1,597,000
Premises Liability	36.9%	13.8%		
Plaintiff			68.7%	$46,100
Defendant			17.5%	$2,378,000
Intentional Tort	35.2%	9.5%		
Plaintiff			69.3%	$43,400
Defendant			21.2%	$859,400
Products Liability	30.2%	11.3%		
Plaintiff			71.7%	$72,600
Defendant			17.0%	$1,327,300
Medical Malpractice	19.5%	4.1%		
Plaintiff			80.8%	$15,200
Defendant			15.1%	$986,200

Journal of Empirical Studies, Volume 5, Issue 3, 551–91,September 2008 titled "Let's Not Make a Deal: An Empirical Study of Decision Making in Unsuccessful Settlement Negotiations," by Randall L. Kiser, Martin A. Asher and Blakeley B. McShane. It can be found at **http://www3.interscience.wiley.com/cgi-bin/fulltext/121400491/PDFSTART**.

error rates increase in cases with high win rates. Have you realistically assessed the chances and costs of losing? Knowing that plaintiff decision error is higher in contingency fee cases than cases without contingency fees suggests focusing on evaluating the interests of the opposing attorney to consider their effect on case analysis and decision making. While many factors can lower decision-error rates for defendants in cases likely to have been insured—including higher settlement rates—perhaps there is an evaluative model utilized by the insurance industry that could improve decision making.

As noted, defendants' decision-error rates increased substantially in cases with punitive damages claims. The researchers opine that this "diminished predictive capacity" suggests that defendants either ignore the claim altogether or "erroneously draw problem-solving analogies" between cases without a punitive damage claim and those with. Or perhaps, the outcome of cases involving punitive damages awards are simply too irrational to predict. In any event, a company defending against a punitive damage claim should separately consider cases in the jurisdiction in which punitive damages were awarded for comparison purposes. Look realistically at the facts that support an award of exemplary damages.

Strategies for Obtaining More Favorable Settlements

Demand and Cultivate Dispute-Resolution Skills

As briefly mentioned, the one characteristic of litigators that affected the quality of settlement-decision making in Kisher, Asher, and McShane's study was whether or not they had been trained as mediators. Many attorneys approach a negotiation or mediation in full advocacy mode, present some version of their closing argument, thus polarizing the opposing party, and miss an opportunity to move a case to a reasonable settlement. Perhaps they behave this way because it's how they are trained and what they believe—rightly or wrongly—their clients expect of them. Corporate counsel can communicate expectations that outside counsel develop effective negotiating skills and use them when called upon to do so.

Litigators go to CLEs on deposition techniques, cross-examination techniques, offering evidence, voir dire, and closing arguments. Although almost all cases will settle, attorneys generally have less training in dispute-resolution advocacy, negotiation skills, and risk analysis.

Stan Davis is a business litigator at Shook, Hardy & Bacon in Kansas City, Missouri, and a former law professor. He still teaches trial practice programs to attorneys at firms all over the country. Mr. Davis has incorporated negotiation and mediation skills into his training: "Junior litigators cannot adequately conduct discovery, develop or analyze a case without understanding evidence and trial strategy. But where the possibility of actually trying a case seems more and more remote it's sometimes difficult to motivate their participation in a trial skills program. Adding dispute resolution training makes it more relevant to their day to day activities."

It may be that those extrinsic factors that caused resistance to settlement early on seem much less important later.

The Early Bird Gets the Worm

The Kisher, Asher, and McShane study provides no information about the thousands of California cases between 2002 and 2005 that did not go to trial. Some would have been resolved legally; some may have been abandoned. The majority of these cases were settled and, since many were subject to confidentiality agreements, data was not available.

That said, another study suggests that early settlements cost less than those later in the process. American Express Company examined 82 employment of its lawsuits settled over a four-and-a-half year period. John Parauda and Jathan Janove, *Settle for Less*, 40 HRMagazine 135 (Nov. 2004). Parauda and Janove reviewed differences among cases settled in either one, two, or three years. Including attorneys' fees, "cases settled in two years cost nearly twice as much… as those settled in one year. Cases settled in three years cost two-and-a-half times as much…" *Id.* at 136. According to the study, factors affecting cost escalation included:

- A plaintiff's attorney fees (generally awardable in an employment case) continuously grew
- American Express fees rose
- As discovery progressed, a plaintiff's commitment to the case grew, as did that of his or her attorney, and the employer lost the advantage of "better access to the facts"
- The passage of time tended to increase lost wages
- A plaintiff's effectiveness became augmented as the trial date loomed, particularly when a summary judgment motion failed
- Managers "became more and more fed up with demands on their time and energy" and thus more willing to settle.

Id. at 136–37.

We've all heard the inner voice saying "if only…" after settling a case near trial for an amount far greater than a plaintiff's original demand—not even counting defense costs and fees. This is not to suggest that you should settle all cases, but rather to suggest that you do your best to utilize resources wisely. It may be that those extrinsic factors that caused resistance to settlement early on seem much less important later. Are they really worth that much money? What are the chances that your case will improve as discovery proceeds? Or are there facts or documents you will have to produce that will serve to energize the other side? How will your witnesses hold up under the scrutiny of a deposition? Can you get the executives you need to testify to spend the time necessary to adequately prepare?

Maximizing the Role of the Neutral

Parties and their attorneys often miss an opportunity to get the greatest possible benefit from a mediator. Understand that the mediator's commitment is to help the parties reach an agreement. Select a medi-

Settlement Savvy › page 74

Settlement Savvy < page 26
ator with a proven resolution track record. It may be helpful to have a mediator with knowledge of the jurisdiction, particular area of the law, or the attorneys involved in the case.

A good mediator will reach out to the parties in advance of the mediation and guide them through the process. Mediators often ask the parties to provide confidential statements of their positions, case history, and prior settlement discussions in advance. Take the extra step to discuss with the mediator observations about impediments to settlement, such as personalities or other issues between the parties that might be land mines. Your mediator can help you to work with an internal client who is having a hard time balancing the trade-offs.

During mediation, use the mediator as a sounding board, to get neutral feedback about aspects of your evidence or the case, to assess the credibility of the representative for the other party, and to explore creative solutions that might even be outside the strict boundaries of the litigation.

According to Susan Hammer, a mediator based in Portland, Oregon, who focuses on business, employment, professional liability, and injury cases, "The best dispute resolution advocates come to mediation ready to learn something new and to thoughtfully analyze cost, risk, opportunity, and non-economic factors. S/he is a counselor. Their clients are prepared to see their lawyers play a different role than they would at trial and they are ready to appreciate it."

Use Offers of Judgment Wisely

Kisher, Asher, and McShane's study suggests that a party can reduce decision-making error rates and costs by effectively using offers of judgment. Perhaps the process of evaluating and making an offer of judgment improves a party's ability to predict the ultimate outcome at trial.

The offer of judgment should be made with a clear understanding of the rules, as well as the consequences. Not only have states codified and applied the concept differently, there is variation among the local rules of the federal district courts. Does the offer cut off attorney fees or only costs? Has it been worded to include costs, and fees, if awardable, then-accrued? Have you considered the consequences if the offer is accepted? For an excellent resource, *see* Teresa Rider Bult, *Practical Use and Risky Consequences of Rule 68 Offers of Judgment*, 33 Litigation 26, 26–30 (Spring 2007).

Conclusion

Given that the vast majority of cases filed do ultimately settle, it's time to improve your settlement savvy. Expand your expectations of advocacy to include better settlement evaluation and negotiation techniques, invite outside counsel to provide realistic assessments and not just posturing. Place a realistic value on principle to ensure that you don't miss an opportunity to settle a case that you know should be resolved early. It is also important to educate internal clients about the nature of litigation and the risks and the costs of those extrinsic considerations that they may value more than warranted by a pure risk analysis. Sometimes that education can come only with experience. When a case settles at the last moment or the company gets a bad jury verdict, take the opportunity to conduct a post-mortem analysis with executive management. Hindsight helps you to evaluate what went right, what went wrong, and what could have been a better decision.