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TRANSACTIONAL INTEREST AND RISK ASSESSMENT

OCTOBER 7, 2020 | JOHN LANDE | LEAVE A COMMENT

By definition, the [LIRA book](#), which provides a framework for [litigation](#) interest and risk assessment, focuses on litigation.

This post describes how it can be adapted for transactional negotiation – transaction interest and risk assessment, or TIRA.

Three Elements

The LIRA framework consists of assessment of three elements: expected court outcome, future [tangible](#) costs of proceeding in litigation, and future [intangible](#) costs of proceeding in litigation.

There are analogs for these three elements in transactions.

In a transactional setting, parties may consider a variety of alternative courses of action, including continuing with the status quo. For example, a seller might consider several possible buyers or not selling at all.

For each plausible option (including the status quo), parties should consider the expected net profit of the alternative, the future [tangible](#) costs of pursuing the option, and future [intangible](#) costs and benefits of the option.

The amount of net profit from a commercial deal may be uncertain because of many factors such as availability and terms of financing, diligence of contracting partners, production efficiency, consumer reaction, market competition, and government actions, among others. So a party might estimate potential net profit of each alternative using a decision tree (or the logic of a decision tree) to consider the probabilities and consequences of various contingencies.

Although the tangible costs of negotiating and consummating a deal are trivial in some cases, they can be substantial in other cases. Parties should consider these costs when they

are likely to be substantial.

Parties may have major concerns about potential intangible costs and benefits of transactions, which may be extremely important to parties. In most cases, the parties may anticipate collateral intangible benefits such as improved public image, development of business relationships, market expansion, and increased technical capabilities. Transactions may create significant intangible risks such as organizational dysfunction or damaged reputation if the deal blows up as well as lost opportunities to pursue other transactions.

In the LIRA book, Michaela Keet, Heather Heavin, and I recommend encouraging parties to assess their situations by assigning monetary values on their intangible interests so that the parties don't overlook or undervalue them. This can be a useful procedure in TIRA as well as LIRA.

Setting Bottom Lines

Parties can set **bottom lines** by deducting the future tangible costs from the expected net profit and making adjustments based on the value of intangible interests. For example, a party might consider a possible deal with an expected net profit of \$100,000 and \$10,000 of future tangible costs of negotiating and consummating the deal. The remaining \$90,000 would be adjusted by the value of future intangible interests such as \$30,000 of value for improved reputation, yielding a value of \$120,000.

In transactional negotiations, parties try to advance their interests and reduce their risks by negotiating to reduce and/or allocate risks. They may negotiate about things such as contingencies, non-competition, confidentiality, licensing, allocation of tax liabilities, insurance, performance bonds, liquidated damages, and indemnity, among others. Negotiators should consider the potential for reaching agreement about such issues and how they would affect the value of transactions.

One of the intangible interests is the level of net benefit needed to proceed with the deal – the “bottom line.” Some parties may set a positive value for the bottom line, other parties may be satisfied if they “break even” considering all these factors, and yet others may be willing to essentially sell “below cost” or buy at a price much higher than the general market value. Parties may be willing to enter a transaction that appears economically unreasonable because of perceived lack of preferable alternatives, time pressure, or other reasons.

In transactional negotiations, lawyers should help clients identify and value factors needed to develop a bottom line. Sophisticated clients may take the lead in this process and lawyers help clients consider factors, especially legal risks, they may have overlooked or not

considered properly. With less sophisticated clients, lawyers take the lead by identifying key factors and helping clients identify and value their interests and then set their bottom lines.

People may change their assessments of the three elements throughout a negotiation, so they should periodically review the calculations when making decisions in negotiation.

As with dispute negotiations, bottom lines function as a trip wire to end negotiation if parties can't reach agreement producing a minimum level of net expected benefit compared with the value of the status quo or other possible deals.

Bottom lines also are particularly relevant in "positional negotiations" in which both parties try to maximize their partisan advantage. In those situations, parties use their bottom lines to plan and implement their negotiation strategies. In this process, parties start with extreme opening offers and make counteroffers designed to reach an agreement more favorable than their bottom lines.

In "interest-based" and "ordinary legal" negotiations, the negotiations focus on parties' interests or general norms (such as industry standards or going rates), respectively. Thus, in these processes, the bottom line is important primarily as a trip wire.

Parties generally don't [use mediators to help in negotiating transactions](#), but parties should consider doing so if there is a substantial possibility of failing to reach a good achievable agreement or if they want help to create as much value as possible in a deal.

In both dispute and transactional negotiations, lawyers and mediators can help clients develop good strategies and make good decisions by using interest and risk assessments.

Thanks to Heather and Michaela for suggestions about this post.

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