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# VALUATION OF CASES FOR SETTLEMENT: THEORY AND PRACTICE\*

*Peter Toll Hoffman\*\**

## I. INTRODUCTION

Trial lawyers frequently talk about the value of their cases when they are counseling clients, negotiating with opposing counsel, or conversing with their fellow attorneys. The term "value" may have several definitions when referring to cases, but most attorneys intend it to mean the amount at which they expect a case to settle. However, despite the frequency with which they speak of value, the subject remains cloaked with a miasma of lawyer folklore.

A review of both the scholarly and practice literature produces very little guidance about not only how the neophyte lawyer should value cases, but also how more experienced lawyers actually arrive at settlement values. The basic theory of settlement is well established, but no similarly accepted theory of valuation exists. Much of the practice literature, in particular, starts with the unsailable premise that before a case is settled it is necessary to know how much the case is worth. Beyond this, the literature sometimes identifies the factors one should examine in arriving at the value of the case,<sup>1</sup> but it does not attempt to provide a general framework for identifying the value of a case or the amount at which a case should be settled.

Despite the lack of information on the subject, the concept of value is important, for several reasons, to understanding negotiation and settlement. Settlement discussions often focus on the value to assign a case, with each side contending for its own and against its opponent's valuation. But more importantly, if one party incorrectly values a case, the outcome of the negotiations will be distorted. If a plaintiff places too low a value on the case or a defendant too high, the case may settle at an amount which does not accurately reflect the potential verdict had the matter proceeded to trial. One side will receive or pay too much and the other side too little.

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1. See, e.g., Magana, *Evaluation and Settlement of Personal Injury Claims*, 441 INS. L. J. 639 (Oct. 1959); H. BAER & A. BRODER, *HOW TO PREPARE AND NEGOTIATE CASES FOR SETTLEMENT* 57-66 (1967).

On the other hand, if the reverse occurs and a plaintiff values a case too high or the defendant too low, settlement becomes difficult or impossible. At a minimum, this prolongs negotiations and unnecessarily consumes the parties' and lawyers' time and resources. At worst, matters that should have been settled proceed to trial, placing heavy burdens on the court system and the parties. In both instances, undervaluing and overvaluing, the parties decide to settle or to proceed to trial without an adequate basis for their decisions and without accurately considering the alternatives available to them.

This discussion provides practitioners with a method of accurately valuing cases in a wide variety of situations. The schema presented is not only helpful to the bar, but also is useful to understanding better the central relationship of valuation to the theory of negotiation and settlement. Finally, throughout the discussion the schema is contrasted with the results of a survey of the bar on how cases are valued in practice. As a result of the survey, suggestions are presented for assisting attorneys in valuing cases.

## II. THE SURVEY

The survey was of lawyers who did not avail themselves of the alternative of settling but instead proceeded to trial by jury and judgment. The purpose of the survey was to determine 1) how these lawyers valued their cases, 2) why their cases failed to settle, and 3) what, if anything, would increase their ability to settle cases. The sample was composed of those lawyers with civil cases that resulted in jury verdicts in a twelve month period in the district court, the court of general jurisdiction, of Lancaster County, Nebraska.<sup>2</sup> In all, interviews were conducted of thirty-six lawyers who had appeared in a total of twenty-two jury trials during the twelve-month period.<sup>3</sup> The types of cases covered a very wide range, from personal injury and contract disputes to condemnation proceedings and conversion actions.<sup>4</sup>

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2. The twelve-month period was from July 1, 1985, to June 30, 1986. Lancaster County is home of the city of Lincoln, the capital of Nebraska. The population of the county is 206,100, of which 89% is within the city limits of Lincoln. In addition to state government, the University of Nebraska's main campus is located in the city as well as a mix of insurance companies, light industry and small businesses. The trial court system in Nebraska has two tiers: 1) the county court with jurisdiction over cases up to \$10,000 in amount; and 2) the district court with general jurisdiction. While either court may conduct jury trials, the district court hears the vast majority of civil jury trials.

3. During the 12-month period, a total of 30 trials were held. Of these, five resulted in a directed verdict or its equivalent, one was resolved by a judgment n.o.v., and one was settled during the course of the trial. Interviews were conducted with lawyers in all but one of the remaining 22 trials. In the trial for which no interviews were conducted, both parties were represented by out-of-state counsel and it was felt little could be learned from them as to why cases failed to settle within Lancaster County, Nebraska.

Of the lawyers, one appeared in four of the 30 trials, one in three, and four in two.

4. The types of actions in the 23 trials resulting in final verdicts were as follows:

15 Personal Injury and/or Wrongful Death

3 Breach of Contract

The survey was not conducted in a manner designed to yield results of statistical significance. The selection of a twelve-month period and the choice of situs for the study had to do with convenience more than with principles of survey research. A complete understanding of why some cases do not settle would require determining not only why those cases that failed to settle resulted in trial but also why the cases that did settle were not pursued to judgment. It also would be useful to know whether bench and jury trials differed in settlement rate and reasons for settlement. Finally, a sample of thirty-six lawyers and twenty-two cases proceeding to trial is too small to be statistically reliable.

Cooperation in any survey is less than perfect. Most of the attorneys contacted were generous with their time in answering questions, but some refused to be so forthcoming. Further distortions arise because any after-the-fact survey relying on the reporting of the participants will suffer not only from the effects of fading memories, but also from what social scientists label the "social desirability effect."<sup>5</sup> In other words, we tend to remember events in a way that places us in the best possible light.

The survey still proved useful, however, by showing what the lawyers who failed to settle their cases perceived as the reasons for that failure and by pointing out specific areas in which those lawyers want and need help. The lawyers' responses about the causes of their failure to settle can be taken only as their own perceptions, of course, and are not necessarily the actual reasons for the failure to settle. Such a failure requires the interaction of two parties, and one party's reporting of the other party's thoughts, motives, and beliefs must be suspect. However, the lawyers' perceptions and suggestions for improvements in the system point toward methods to improve the valuation of cases and, in turn, the settlement process and decrease the potential burdens of litigation.

### III. THEORY

Determining why certain cases do not settle first requires understanding why any cases do settle. The basic theory of settlement has long been recognized:<sup>6</sup> A rational party should settle only if it can obtain at least what it would achieve by proceeding to trial and verdict, taking into account all of the economic and

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- 1 Assault and Battery
  - 1 Condemnation
  - 1 Conversion
  - 1 Misrepresentation

5. See D. PHILLIPS, *KNOWLEDGE FROM WHAT?* 86-88 (1971).

6. The theory of settlement presented here is confined to what are labeled "rights disputes." Rights disputes presuppose an external principle or standard by which the claim can be settled. Litigation disputes fall within the rights disputes category and are the focus of this discussion. See Perritt, *And the Whole Earth Was of One Language—A Broad View of Dispute Resolution*, 29 VILL. L. REV. 1221, 1229 (1983-84).

noneconomic costs of both settlement and trial.<sup>7</sup> A plaintiff, for example, should never accept less in settlement than what it estimates it would receive in the way of a verdict at trial, discounting for the expected expenses of proceeding to trial and for any other anticipated economic, social, psychological, and legal costs. Similarly, a defendant should not pay out in settlement any more than what it expects to lose at trial, increased by the expense of trial and any other expected economic and noneconomic costs that trial would entail. The point where a party is indifferent to whether the case goes to trial or settles is the party's break-even point, or reservation price.<sup>8</sup>

Settlement, therefore, will occur only when both parties perceive themselves better off with the results of a negotiated resolution than with those of a trial, where one or the other would prevail. As an example, imagine two parties who each predict that the outcome of trial will be a verdict for the plaintiff in the amount of \$1,000; liability is clear and the damages are fixed. Also assume that each party will incur nonshiftable litigation expenses of \$500 by proceeding to trial and for trial itself, and there are no other costs of any kind. The result of trial will be a net recovery of \$500 for the plaintiff (judgment of \$1,000 minus attorney fees of \$500) and a net loss of \$1,500 to the defendant (judgment of \$1,000 plus attorney fees of \$500). Both sides will be better off settling at any amount between \$500 and \$1,500 than proceeding to trial.<sup>9</sup>

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7. See Note, *An Analysis of Settlement*, 22 STAN. L. REV. 67, 70-71 (1969) ("Litigants settle out of court for only one reason: Each thinks he obtains through the settlement agreement an outcome at least as good as his estimated outcome in court."). The Note is a sophisticated and often cited analysis of the economics of settlement. While recognizing the importance of non-economic factors in resolving disputes, e.g., aversion to risk, the Note does not integrate these into its theory of valuation. Nonetheless, much of the following discussion of the theory of settlement is drawn from the Note. Another valuable review of valuation and negotiation theory is G. BELLOW & B. MOULTON, *THE LAWYERING PROCESS* 430-606 (1978). More theoretical but valuable discussions are found in Gould, *The Economics of Legal Conflicts*, 2 J. LEGAL STUD. 279 (1973); Posner, *An Economic Approach to Legal Procedure and Judicial Administration*, 2 J. LEGAL STUD. 399, 427-29 (1973); and H. RAIFFA, *THE ART & SCIENCE OF NEGOTIATION* 44-65 (1982). For the mathematically inclined, there are several highly refined economic analyses of negotiation and settlement that often suffer from unrealistic assumptions. See, e.g., Bebchuk, *Litigation and Settlement Under Imperfect Information*, 15 RAND J. EC. 404 (1984); Reinganum & Wilde, *Settlement, Litigation, and the Allocation of Litigation Costs*, 17 RAND J. EC. 557 (1986).

8. Note, *supra* note 7, at 70-71; C. CRAVER, *EFFECTIVE LEGAL NEGOTIATION AND SETTLEMENT* 39 (1986); D. LAX & J. SEBENIUS, *THE MANAGER AS NEGOTIATOR* 46-47 (1986); Hartje, *Lawyer's Skills in Negotiations: Justice in Unseen Hands*, 1984 J. DISP. RESOL. 119, 137-38. Fisher and Ury use the term BANTA (Best Alternative To A Negotiated Settlement) in urging that negotiators determine what is the fall-back or best alternative against which any proposed agreement should be measured. While BANTA encompasses within it the concept of a break-even point, it is a broader concept covering all types of negotiated agreements. R. FISHER & W. URY, *GETTING TO YES* 104 (1981).

9. J. SHAPARD, *THE INFLUENCE OF RULES RESPECTING RECOVERY OF ATTORNEYS' FEES ON SETTLEMENT OF CIVIL CASES* 11-12 (1984):

Under the American rule [of awarding attorneys' fees], settlement is possible whenever the difference between the expected verdicts as seen by plaintiff and defendant is less than the sum of their attorneys' fees. The width of the bargaining span is the amount by which

The difference between the plaintiff's break-even point, \$500, and the defendant's break-even point, \$1,500, is known as the parties' *bargaining range*.<sup>10</sup> Introducing a greater degree of reality by incorporating the parties' reactions to risk, to differing predictions of the outcome of trial and to other economic and noneconomic factors will cause the break-even points and bargaining range to shift in ways to be discussed.

The bargaining powers and skills of each side determine the amount that the parties ultimately settle on within the bargaining range. No natural or economically dictated point of settlement exists, only an amount somewhere within the bargaining range of the two parties.<sup>11</sup> In the negotiation process, the parties attempt to convince each other that each is at or near their break-even point and therefore it is in the other's best interest to settle; but each also tries to convince the other to modify or change its break-even point, to extend the bargaining range.<sup>12</sup>

Obviously, if there is no bargaining range—no point at which the parties can settle and each perceive that it is receiving at least what it would receive by proceeding to trial and verdict, taking into account all of the economic and noneconomic costs of trial and settlement—there should be no settlement. But as long as there is a bargaining range, it is in both parties' interest to settle rather than go to trial.<sup>13</sup>

Determining the point at which a party views trial and settlement as equally attractive is the process of valuing the case. The attorney and client are setting the break-even point or settlement value of the case: the point at which, if the parties cannot reach a settlement, the case will go to trial.

#### IV. VALUATION

In practice, the process of valuing a case assumes a number of forms, ranging from the primitive to the sophisticated. At both ends of the continuum, valuation often consists of the lawyer intuitively arriving at a settlement value figure. Though the end product, an intuitively arrived-at settlement figure, is the same, the

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the sum of the fees exceeds the difference in expected verdicts.

*Id.*

10. A synonym for bargaining range is "zone of agreement." H. RAIFFA, *supra* note 7, at 45; Perritt, *supra* note 6, at 1248.

11. See Schelling, *An Essay on Bargaining*, 46 AM. ECON. REV. 281, 281-82 (1956); Gould, *supra* note 7, at 287.

12. G. BELLOW & B. MOULTON, *supra* note 7, at 489-90. See Gifford, *A Context-Based Theory of Strategy Selection in Legal Negotiation*, 46 OHIO ST. L.J. 41, 51 (1985). A massive body of practice literature discusses the tactics of bargaining. See, e.g., H. COHEN, *YOU CAN NEGOTIATE ANYTHING: HOW TO GET WHAT YOU WANT* (1980); C. KARRASS, *THE NEGOTIATING GAME* (1970); G. NIERENBERG, *THE ART OF NEGOTIATING: PSYCHOLOGICAL STRATEGIES FOR GAINING ADVANTAGEOUS BARGAINS* (1968).

13. Note, *supra* note 7, at 71. See Gould, *supra* note 7, at 285-86.

process by which experienced lawyers value their cases differs markedly from the process newcomers to the profession follow.

Through repeated practice, the experienced lawyer has developed an almost unconscious calculus that incorporates past valuations with an assessment of their accuracy, a knowledge of prior verdicts and settlements, and the relationship of past experiences to the facts of the current case. In recounting the mental procedures they follow in arriving at a settlement value, the experienced trial lawyers in the survey used such descriptive phrases as, "It's just a gut feeling"; "It's looking at what I believe a jury will believe"; and "It's like being pregnant; you just have a feeling." Thus, experienced lawyers often are not able to articulate the process by which they reached a valuation figure, but a sophisticated unconscious analytical process yields that figure and the experienced lawyer acts upon it with confidence.<sup>14</sup>

At the other extreme are inexperienced lawyers who use conjecture and speculation to determine settlement values. They often resort to "common sense" to arrive at a figure, because they have a limited experiential base and little knowledge of the process of valuation or of how to obtain the information necessary to intelligently price the claim.

The survey also revealed a group of lawyers who have taken themselves completely off the continuum, by refusing to calculate the value of their cases. This group of lawyers gives the client, at most, an assessment of liability and then asks what the client would be willing to give or take in settlement to avoid trial. Interestingly enough, two groups of lawyers use this approach: those with very little experience and those with experienced, sophisticated business clients.

The inexperienced lawyers may use this approach because they are uncomfortable or unable to value the case and therefore shift the responsibility to the clients. The lawyers of experienced clients most frequently were representing collection agencies in pursuit of debtors. These clients desired the lawyer's evaluation of the legal issues in the case, but they were adept at assessing the degree of risk they were willing to incur and quickly arrived at the amount by which they were willing to compromise a claim.

Between the intuitive and the speculative extremes is a wide variety of approaches to calculating a case's settlement value. Some are quite simple and crude, such as the use of formulae (e.g., the settlement value of a personal injury

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14. See Fuchsberg, *Realistic Settlement Techniques*, 1 TRIAL LAW. Q., No.2 at 22 (1964); H. ROSS, SETTLED OUT OF COURT 96-97 (1970); Blum, *What's a Leg Worth? It Depends*, NAT'L L.J., Aug. 1, 1988, at 1.

A plausible explanation for this behavior is that the experienced attorneys have incorporated decision-making heuristics into their unconscious calculus of valuation. See generally Moore, *Trial by Schema: Cognitive Filters in the Courtroom*, 37 UCLA L. REV. 273 (1989); Sherman & Corty, *Cognitive Heuristics*, in 1 HANDBOOK OF SOCIAL COGNITION 189 (R. Wyer & T. Srull eds. 1984). Ross reports the use of explicit "rules of thumb" by attorneys and claims adjusters in valuing simple personal injury claims as a method of efficiently arriving at a damage figure. H. ROSS, *supra*, at 106-16. For a discussion of heuristics and their fallibility, see generally JUDGMENT UNDER UNCERTAINTY: HEURISTICS AND BIASES (D. Kahneman, P. Slovic, & A. Tversky eds. 1982).

case is six times the special damages in the case),<sup>15</sup> and others are quite sophisticated and complex. For example, a computer program is available that will determine the settlement value of a case, based on data about the type of injury, the parties, the damages incurred, and a catalog of other factors.<sup>16</sup> The settlement figure produced is based upon verdicts obtained in similar cases that have been incorporated into the program.

## V. THE SCHEMA

From the responses obtained in the survey and through an examination of the scholarly and practice literature on negotiation and settlement of claims, it is possible to construct a schema for valuing claims. The suggested schema proposes that valuation proceed through four distinct steps in order to accurately estimate the point at which a party should be indifferent between settlement and trial, the party's break-even point. These are: 1) determining the distribution of verdicts in similar claims; 2) adjusting the distribution of verdicts in similar claims to reflect the unique facts of the particular claim; 3) adjusting the revised distribution to reflect transaction costs; and 4) selecting a settlement value reflecting the client's preferences and values.

The schema has one important limitation: it does not relate to integrative bargaining situations. Instead, it is confined to what is known as share or distributive bargaining, where one party's gain is the other party's loss.<sup>17</sup> The survey was limited to jury trials, which are law actions. Arising on the law side of the docket, such actions must be for the awarding of damages and cannot be seeking any sort of equitable relief. As such, the actions are seeking the transfer of monies in the equivalent manner of distributive bargaining.<sup>18</sup> Distributive bargaining also comprises the vast majority of legal negotiations leading to the settlement of legal claims whereby a party pays some sum of money to its opponent.

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15. See H. BAER & A. BROADER *supra* note 1, at 60-61; G. WILLIAMS, *LEGAL NEGOTIATION AND SETTLEMENT* 115 (1983); H. ROSS, *supra* note 14, at 102-11, 239.

16. *JVR Case Evaluation Software for the Evaluation of Personal Injury Case*, Jury Verdict Research, Inc., Solon, Ohio (1990 and subsequent years).

17. See D. GIFFORD, *LEGAL NEGOTIATION: THEORY AND APPLICATIONS* 15 (1989).

18. Several commentators, particularly Professor Menkel-Meadow, argue that lawyers are too narrow in their analysis of settlement opportunities by focusing only on distributive bargaining solutions. These commentators insist that many times integrative solutions exist to problems that traditionally have resulted in distributive bargaining settlements. See Menkel-Meadow, *Toward Another View of Legal Negotiation: The Structure of Problem Solving*, 31 *UCLA L. REV.* 754 (1984); Menkel-Meadow, *Legal Negotiation: A Study of Strategies in Search of a Theory*, 1983 *AM. B. FOUND. RES. J.* 905; Hartje, *supra* note 8, at 121-22. While the general proposition is no doubt true, the situations in which it can be applied are of a limited number. First, integrative bargaining requires more lawyer and client resources than the stakes of most cases would justify. Second, it is the author's experience that, even where integrative solutions are proposed, the parties monetize the proposed solutions and relate the solutions to what is achievable by pursuing the claim to trial, thereby ending up with approximately the same outcome as distributive bargaining.



*A. Step One: Determining the Distribution of  
Verdicts in Similar Claims*

Before a party can calculate its break-even point, the amount at which it is indifferent between settlement and trial, it must have some estimation of the anticipated outcome of trial against which it can compare any settlement offer. To make a comparison, it is not only necessary to predict whether the plaintiff or defendant will prevail, but what amount of damages will be awarded must be calculated as well. The difficulty of accomplishing this task depends, in part, on the legal standards used in determining damages.

When the law applies an objective measure of damages, estimating the anticipated verdict amount becomes a comparison of the money value of the damages against the applicable standard. For instance, if the case arises in tort and the injury consists solely of damage to property, most jurisdictions measure the damages suffered by the lesser of the cost of repair or the diminution in value of the property.<sup>19</sup> To determine the value of these damages and, therefore, the anticipated verdict amount, a lawyer simply establishes the fair market value of the property and the costs of repair and then selects the lesser of the two. Similarly, in breach of contract claims, damages typically are measured by the plaintiff's losses attributable to the breach, a matter of calculation based on an objective standard.<sup>20</sup> There may be difficulties in assembling the necessary proof and a judge or jury may be required to choose between competing estimates of these damages and to weigh and resolve conflicts in the evidence. Once these matters are resolved, however, the amount of damages can readily be calculated against the applicable standard using simple arithmetic methods.

The situation is entirely different when the measure of damages requires a subjective determination. For instance, in a personal injury case, the jury instructions concerning pain and suffering typically provide a jury with almost no guidance in calculating what sum to award a plaintiff.<sup>21</sup> The jury is left almost entirely to its own devices and the arguments of counsel in calculating the damages to grant. The lawyer's problem is how to estimate what a jury will award when applying such an amorphous standard to the anticipated evidence.

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19. See, e.g., *Chlopek v. Schmall*, 224 Neb. 78, 88-89, 396 N.W.2d 103, 110 (1986).

20. See, e.g., *Gallagher v. Vogel*, 157 Neb. 670, 680, 61 N.W.2d 245, 251 (1953).

21. See, e.g., *NJI2d* 4.01:

**GENERAL INSTRUCTIONS ON DAMAGES—PERSONAL INJURY**

If you return a verdict for the plaintiff, then you must decide how much money will fairly compensate the plaintiff for his injury.

I am about to give you a list of the things you may consider in making this decision. From this list, you must only consider those things you decide were proximately caused by defendant's negligence:

....

5. The physical pain and mental suffering the plaintiff has experienced.

See generally Kalven, *The Jury, the Law, and the Personal Injury Damage Award*, 19 OHIO ST. L.J. 158, 159-64 (1958).

The facts of the case alone cannot provide the answer; instead, some other predictive device must be sought.

The best predictor is what verdicts have been returned in cases similar to the case being valued. The only method of estimating what a jury will award in response to the facts of a case is to examine what juries in the past have given in considering similar cases. Therefore, the first step in computing a party's break-even point in a case applying a subjective measure of damages is to determine what verdicts have occurred in claims similar to the claim being valued.

When an objective measure is being applied, determining a party's break-even point should begin with Step Two of the schema. How similar claims have been decided in the past provides little guidance about how the judge or jury will measure the proof presented in the particular case against the applicable standard, basically an arithmetic calculation. Reasonable cover in one contract case is likely to be so different in kind and amount than in another contract case, even where the facts are similar, that looking to past verdicts will provide little predictive value.<sup>22</sup> Instead, the lawyer must apply the standard to the evidence of the particular case and make predictions based on the facts of the case alone, a process described in Step Two.

In collecting information on verdicts being returned in similar claims for use in valuing a claim with a subjective measure of damages, an unsorted mass of data is of no use to clients or lawyers. Sometimes only a few verdicts are available for comparison and then it is only necessary to present the information in the way most understandable to the particular client, usually by a short description of the underlying facts and the verdict amount. But when there are a large number of verdicts, then some other method is necessary. A frequency distribution is a method of presenting such information in a useful form by presenting a tabulation of the number of verdicts returned at each amount. The information can be presented in a graph form indicating the percentage and number of verdicts at each amount of recovery, including verdicts for the defendant.

A frequency distribution can be made even more useful by also calculating the median and mode verdicts. The median verdict is the average of all of the verdicts collected while the mode is the most frequently occurring verdict. Obviously, mean and mode verdicts can only be calculated if there are an adequate number of verdicts upon which to draw.<sup>23</sup>

While the number and amount of verdicts being returned in similar claims is essential to predicting the verdict amount in the claim being valued, of less importance is information on the number of claims resulting in a finding of no liability. Unlike predicting damages, predicting liability in the particular case

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22. Of course, cases involving an objective measure of damages do exist where the facts are so similar that a jury hearing one will calculate damages the same as in the other. Such cases, however, are the exception.

23. See generally D. BARNES, *STATISTICS AS PROOF* (1983). While it is quite possible to set forth the calculations necessary to arrive at a statistically reliable sampling of verdicts, the schema presented is intended to be used by lawyers without knowledge of sampling theory or statistics. Professor Barnes' book serves as a useful introduction to the subject.

based on results in past cases is of limited utility. Factual differences between the similar claims and the particular claim make predictions about the particular claim problematic because of the difficulty of isolating those factors on which liability is premised. A witness may not have been credible, a particular exhibit may have been present in one case and not another, and so on, making comparisons tenuous between the sampled cases and the particular case.

On the other hand, the probability of liability in a class of cases may give an attorney a general guide to how judges or juries react to a generic factual pattern of the type present in the particular case. The distribution may show, for example, that plaintiffs injured while riding motorcycles and who have suffered only soft tissue injury are less likely, on average, to prevail at trial than those with objectively verifiable injuries and driving automobiles.

### 1. Collecting Past Verdicts

Several methods to determine past verdicts are available. Many lawyers, for their own use, keep records of verdicts in their jurisdictions, either formally, such as by listing them in a notebook, or informally, by remembering what juries have been returning. Several of the surveyed attorneys reported that they or their firm kept a record of verdicts returned in Lancaster County or the broader practice area. Several more stated that, while they kept no formal record of verdicts, they were familiar with the verdicts being returned and made reference to these verdicts in valuing cases.

While neither Lancaster County nor Nebraska have such a service,<sup>24</sup> more populous jurisdictions often have a commercial verdict reporting service to which lawyers may subscribe for a fee.<sup>25</sup> On a national level there are several different verdict reporting services, such as the *Personal Injury Valuation Handbooks*, upon which many of the surveyed attorneys rely.<sup>26</sup>

On its face, the process of determining the distribution of verdicts in similar cases should be quite easy and straight forward. However, there are many difficulties and opportunities for error, even for the experienced lawyer. Assembling verdicts in similar cases may be an arduous and expensive if not impossible task. Many jurisdictions do not have any verdict reporting service that makes verdicts and the facts supporting them available and easily accessible. Even when a jurisdiction has a central point for the collection of verdict amounts, this information is useless unless coupled with some explication of the facts in the case; dollar amounts alone are of no help. Tracking down verdicts as they are

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24. The publication of the Nebraska Association of Trial Attorneys, *The Prairie Barrister*, contains reports of verdicts and settlements submitted by its readers. This is a less than complete listing and is not indexed in any way but is the most complete service available in Nebraska.

25. See G. WILLIAMS, *supra* note 15, at 115-16 ("Since predicted outcome at trial is the most common measure of case value, attorneys commonly refer to published reports of jury verdicts for assistance in case evaluation.")

26. JURY VERDICT RESEARCH, INC., *PERSONAL INJURY VALUATION HANDBOOKS* (Supplemented annually).

periodically announced and interviewing the lawyers involved to find out the underlying facts can be too time-consuming to be practical for the average lawyer. Relying on courthouse gossip may provide inaccurate or distorted information when only major or unique cases are discussed.

The difficulty of learning what verdicts are being returned and the importance of such information is reflected in the surveyed lawyers' responses to the question of what would help them settle cases. Without any prompting, twelve of the thirty-six lawyers surveyed stated that some form of jury verdict reporting service would be helpful.<sup>27</sup>

The need for a method to determine verdicts becomes even more apparent when examining the breakdown between experienced, medium experienced, and inexperienced attorneys in the survey.<sup>28</sup> Twelve of the thirty-six surveyed lawyers were experienced. Of these, only one gave the reporting of verdicts as a need in improving the ability to settle cases. In contrast, five of the seven inexperienced attorneys and six of the seventeen medium experienced attorneys reported this need. Apparently, as attorneys become more experienced and presumably more familiar with the verdicts being returned for various types of claims, the need for a verdict reporting service lessens.

Further evidence of the need for the reporting of verdicts is the number of attorneys who use the *Personal Injury Valuation Handbooks* in valuing cases. The *Handbooks* collect verdicts on a nationwide basis, including verdicts from Nebraska, but the reporting is not complete.<sup>29</sup> In addition, the *Handbooks* set out a series of calculations that are designed to produce a settlement value for personal injury cases. However, many of the experienced lawyers in the survey reported that the *Handbooks* overestimated settlement values for Nebraska. Despite this perception, two of the experienced, six of the medium experienced, and four of the inexperienced attorneys reported using the *Handbooks* in valuing personal injury cases.

Repeat players, those attorneys retained by insurance companies or who regularly handle particular types of cases, are not as handicapped in obtaining verdict information. Many of them or the insurance companies they represent maintain formal or informal files on verdicts and settlements. But the attorneys who only occasionally handle particular types of claims consider the lack of information on verdicts a source of difficulty.

Even in jurisdictions where verdicts are reported in some usable form, difficulties persist. The particular case being valued may be unique or be one of first impression, so that verdicts for similar claims do not exist. Such a situation leaves the lawyer with little choice but to extrapolate from his or her knowledge

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27. Many of the surveyed attorneys made more than one suggestion as to what would assist them in being better able to settle cases. See Appendix 1.

28. The determination of the experience level of the surveyed lawyers was based on reported trial and litigation experience, as well as reputation in the legal community and personal contact and experience with them.

29. The verdicts are collected through cooperating court clerks and attorneys, but, according to conversations with the company, the reports are less than complete.

of how juries react in general and from analogous factual situations. Only one of the surveyed lawyers, when valuing a case with unusual psychological damages, reported encountering this difficulty, but, given the stated need for the reporting of verdicts in the local area, others no doubt have encountered the same problem.<sup>30</sup>

Obviously, the closer the match between the facts of the similar cases and the particular case, the greater the predictive value of the similar cases. But factual similarity is only one factor important to computing predictive value. Others include:

1) Are the cases from the same jurisdiction as the one in which the particular case has been or will be brought? If not, an adjustment must be made in the distribution of the similar cases, to reflect differences between the jurisdictions.

2) How many similar cases are there? The predictive value of similar verdicts depends, in part, on how representative the sampled verdicts are of future jury behavior. If there is a large number of verdicts, a lawyer can say with greater confidence that a jury in the particular case will return a verdict within a particular range than if there are only a few.

3) How recently decided are the similar cases? The greater the period of time between the sampled verdicts and the particular case, the less the predictive value of the similar cases. The effects of inflation on tort awards as well as the general upward trend in awards in recent years for at least certain types of claims cannot go unnoticed in its effects on the usefulness of past verdicts.<sup>31</sup>

4) How similar are the damages of the sampled verdicts to the damages of the particular case? The match between the damages of the sampled cases and the particular case is never perfect, but the more closely similar, the greater the predictive value. Difficulties in matching become particularly troublesome in multiple injury cases, because the exact mix of injuries is rarely duplicated.<sup>32</sup>

## 2. Settlements in Similar Claims

The problem of assembling a sample of verdicts becomes particularly acute in smaller jurisdictions where any type of verdict is rare. Attorneys in this situation must resort to comparison cases from larger jurisdictions and then adjust

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30. See Galanter, *Reading the Landscape of Disputes: What We Know and Don't Know (And Think We Know) About Our Allegedly Contentious and Litigious Society*, 31 UCLA L. REV. 4, 29 (1983).

31. See M. PETERSON, *COMPENSATION OF INJURIES: CIVIL JURY VERDICTS IN COOK COUNTY* 46-56 (1984).

32. See Leebron, *Final Moments: Damages for Pain and Suffering Prior to Death*, 64 N.Y.U. L. REV. 256, 290 (1989); M. PETERSON, *supra* note 31, at vi.

the resulting distribution as well as possible to reflect the differences between the jurisdictions.

Even in larger jurisdictions, certain types of claims are routinely settled, making it difficult to assemble a sample of similar verdicts.<sup>33</sup> The routine settlement of cases occurs when liability is usually clear or when the cases are perceived to be of such limited value that there is little economic justification for pursuing the matter to a verdict.<sup>34</sup> For example, injuries resulting from rear-end collisions are an extremely common type of claim. Perhaps because of their frequency, the rules of liability are well-settled, and the driver of the vehicle following behind almost always pays. Serious injuries can and do result from this type of accident, but the typical claim involves only property damage and personal injuries with out-of-pocket damages of less than \$2,000. Unless there is an inflated claim for damages, it makes little economic sense for a defendant to incur the expense of trial and an almost certain verdict against it.

Similarly, plaintiffs' attorneys working for contingency fees have little incentive to gamble on the outcome of trial for marginally greater damages unless the defendant is being unreasonable in its settlement offer. The clients also have strong encouragement to accept a settlement if their attorneys are working under contingency fee agreements that increase the attorneys' percentage in the event of trial.<sup>35</sup> As a result, almost all of these claims are settled without proceeding to trial, and the lawyer evaluating this type of claim has almost nothing in the way of similar verdicts at which to look.

All of these factors make valuation difficult in many common smaller claims. Recognizing that very few of these claims ever proceed to trial, lawyers turn to what similar claims have settled for in the past. The relevant market becomes not what a jury would award if the claim were taken to trial, but the amount at which such claims are being settled by other attorneys. The potential verdict in a case is a useful predictor only if there is any possibility the claim will be taken to trial. If both parties know that economic constraints realistically prevent trial, then they must look to some other norm for guidance in determining the amount at which a claim should be settled, in this instance the settlements being reached in similar claims.<sup>36</sup>

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33. While the number of court filings continue to rise, the percentage of cases going to trial has been falling, even though the absolute number of trials is increasing. Galanter, *supra* note 30, at 43-46.

34. See G. BELLOW & B. MOULTON, *supra* note 7, at 486 n.18; H. ROSS, *supra* note 14, at 111-12.

35. See generally Kritzer, Felstiner, Sarat & Trubek, *The Impact of Fee Arrangement on Lawyer Effort*, 19 LAW & SOC'Y REV. 251 (1985); Schwartz & Mitchell, *An Economic Analysis of the Contingent Fee in Personal Injury Litigation*, 22 STAN. L. REV. 1125 (1970); Clermont & Currihan, *Improving on the Contingent Fee*, 63 CORNELL L. REV. 529 (1978); Franklin, Chanin & Mark, *Accidents, Money and the Law: A Study of the Economics of Personal Injury Litigation*, 61 COLUM. L. REV. 1 (1961).

36. Settlement, as well as adjudication, may have precedential value. Eisenberg, *Private Ordering Through Negotiation: Dispute-Settlement and Rulemaking*, 89 HARV. L. REV. 637, 653 (1976).

The significance of settlements in similar claims became apparent in the surveyed attorneys' response to the question of what would assist them in better achieving settlements. Eight of the respondents stated that a reporting system for settlements would be helpful. More interesting is the breakdown of these eight. Over 70% of the inexperienced attorneys and over 30% of the medium experienced attorneys stated a need for the reporting of verdicts, but three of the eight attorneys desiring the reporting of settlements were experienced, four were medium experienced, and only one was inexperienced. It may be that only with experience do lawyers become aware of the existence of a separate settlement market.

The remarks of an experienced attorney in the survey who primarily represents personal injury defendants and their insurers illustrates the difficulty of valuing claims that rarely proceed to trial. He reported that one of the insurance companies which frequently employs him is looking for a rear-end collision-whiplash case, with facts favorable to the defendant, to force to trial. The company's perception is that the only local verdicts for such cases were decided so long ago that they are no longer accurate guides as to what a jury would return today, especially in light of a perception that verdict amounts of all types in Lancaster County have been declining in recent years. Because of the frequency of such claims, the company was seeking to establish a new benchmark of value.

Both parties in a suit know the hesitancy to take minor claims to trial has its limits. An attorney's reputation will suffer from a settlement which receives significantly less or pays significantly more than the settlements other attorneys in similar cases are achieving. Both sides are willing to incur the expense of trial rather than suffer the loss of face an unsatisfactory settlement would cause. Each side also attempts to use its opponent's understanding of this principle to maintain a credible threat of going to trial, exacting whatever settlement leverage arises from the threat of forcing the other side to incur the expenses of trial.<sup>37</sup>

The final difficulty in determining the distribution in similar claims is that the process can produce only a dollar range and not a specific figure. That a range of verdicts is produced is not surprising; as previously noted, judges and juries assessing damages under a subjective measure receive virtually no guidance in calculating the amount to award. Left to their own devices, each will arrive at its own estimation of the value of such damage items as pain and suffering.<sup>38</sup> Coupled with the factual uniqueness of each case, it follows there will be a range of verdicts instead of one figure. The wider the range and the more dispersed the distribution of verdicts, the less useful the predictive value of the distribution. Even refining the distribution by calculating the mean and mode verdicts, which

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37. See H. ROSS, *supra* note 14, at 195-96, 237.

38. Judges in bench trials may be more predictable in assessing damages. Presumably they take account of previous verdicts rendered both by them and by juries in their courts and attempt to be consistent with those verdicts. See generally Ogus, *Damages for Lost Amenities: For a Foot, a Feeling or a Function*, 35 MOD. L. REV. 1, 4-5 (1972).

does make the distribution more useful, may mislead attorneys and clients into a false sense of certainty associated with a definite figure.

In conclusion, the first step of the valuation process requires determining the verdicts being returned in similar claims. If the number of verdicts is small, the information can be presented by any method that makes it easily understandable. If numerous verdicts are available, a frequency distribution should be assembled setting forth the number and percentage of verdicts returned at each amount including verdicts for the defendant. In addition, the mean and mode verdicts should be calculated.

### *B. Step Two: Adjusting the Distribution for Similar Claims To Reflect the Unique Facts Of the Particular Claim*

Whether the sampled verdicts accurately predict the potential verdict range and probability of recovery in the particular case depends to a large extent on the degree of match between the facts of the sampled verdicts and the case being valued. Because the match is never perfect, one must adjust the distribution to reflect the unique facts of the particular case. Yet, as a general rule, only those cases in which the issues of liability or damages are closely disputed proceed to trial.<sup>39</sup> Thus, the recoveries and the rate of liability in the sampled verdicts represents only similarly closely disputed cases.

Yet each case is unique. The facts giving rise to liability, the damages suffered, the characteristics of the parties, and so on, are all highly individualistic. Average verdicts and rates of recovery mean little when attempting to extrapolate from one case to another, but instead analysis and judgment must be substituted for statistical computation. The lawyer must examine the facts of the case being valued and compare the facts with those of the similar claims to determine whether the probability of liability should be adjusted upward or downward to reflect any differences. Similarly, the reported damages in the similar claims must be compared to the damages in the claim being valued and the necessary adjustments made to the verdict distribution.

Individualized examination of the facts is also necessary when damages in a case are measured against an objective standard. Valuation of such claims begins with Step Two because verdicts in similar claims provide little guidance

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39. See generally Priest & Klein, *The Selection of Disputes for Litigation*, 13 J. LEGAL STUD. 1 (1984). There are exceptions, of course, to the general rule. The organizational dynamics of insurance companies, for instance, may make it difficult for an adjuster to authorize the payout of a large settlement amount. To avoid later criticism from higher levels of management, the prudent course of action for an adjuster may be to permit such cases to proceed to trial, thereby shifting responsibility to the courts and lawyers. See H. ROSS, *supra* note 14, at 166; Dan-Cohen, *Bureaucratic Organizations and the Theory of Adjudication*, 85 COLUM. L. REV. 112, 124-25 (1985); Galanter, *supra* note 30, at 29; see also Franklin, Chanin & Mark, *supra* note 35, at 19. Wittman argues from an economic perspective that the larger the potential award, the more likely trial will occur. Wittman, *Dispute Resolution, Bargaining, and the Selection of Cases for Trial: A Study of the Generation of Biased and Unbiased Data*, 17 J. LEGAL STUD. 313, 314 (1988).



about the potential for a finding of liability or the amount of damages. With this category of cases, it is necessary to calculate the potential verdict by carefully analyzing the facts and law, without considering similar claims except as they illustrate an issue in the case.

### 1. Sources of Adjustment

Assessing liability and damages, whether for a case with an objective or a subjective measure, is a function of the lawyer weighing innumerable factors and predicting how a judge or jury will react to them. Essentially this process is beyond precise description, but it can be broken down into the broad categories of assessing the law and assessing the facts.<sup>40</sup> The law provides the governing standard against which the facts are measured in determining liability. To fully assess the impact of the governing law on the outcome of the case, the lawyer must not only identify the applicable legal standard, that is, the elements of the applicable claims and defenses, as well as the measure of damages, but also must determine the quality of proof required, e.g., a preponderance of the evidence, and the party bearing the burdens of persuasion and production for each issue.<sup>41</sup> Without such a careful analysis of the law, a lawyer cannot assess potential liability and damages in a case.

In most cases, the governing law is clear and easily ascertainable. However, even the most skilled attorneys at times make mistakes in research. More importantly, the applicable legal rule may not yet have been announced if the case is one of first impression in the jurisdiction. Or, as is not uncommon, the governing law may be in flux, and cases from the same jurisdiction may be found on either side of an issue. The most common situation, however, is that the rule, while clear, does not squarely fit the facts of the particular case.<sup>42</sup> Without clear precedent upon which to rely, the lawyer is left to examining cases from other jurisdictions, related but different cases, and any other source that might provide guidance in predicting how the court ultimately will rule on the issue.<sup>43</sup>

Measuring the known facts against the applicable legal standard is the other half of assessing liability. Certainly if the plaintiff cannot make out a *prima facie*

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40. For a description of the techniques used by insurance claims adjusters in valuing cases, see H. ROSS, *supra* note 14, at ch. 3.

41. The answers to these questions are not only important for valuation purposes but also provide a source of arguments for the parties to use in the course of the negotiations. They become bargaining chips or endowments for one side or the other. See generally Mnookin & Kornhauser, *Bargaining in the Shadow of the Law: The Case of Divorce*, 88 YALE L. J. 950, 968-69 (1979) (legal rules governing alimony, child support, and custody give divorcing parents bargaining chips for negotiating based on what each would get under a court order if they cannot reach an agreement); Galanter, *supra* note 30, at 32-33.

42. See generally J. RAZ, *THE AUTHORITY OF LAW* 172 (1979).

43. See Wald, *Negotiation of Environmental Disputes: A New Role for the Courts?*, 10 COLUM. J. ENVTL. L. 1, 11 (1985) ("[L]egal perplexity about the principles governing the scope of liability and rights of contribution currently impede . . . settlements. Certainly, from a judicial observer's point of view, even more specific statutory guidance for settlements seems desirable.").

case under the applicable legal standard, the action will end with a dispositive motion prior to or during trial and will never reach the jury. Prevailing on the merits, however, as opposed to surviving a motion for a directed verdict or dismissal usually requires more than merely making out a prima facie case; the lawyer must convince the fact finder that the proffered version of the facts and the favorable inferences therefrom are true.

How a judge or jury, in determining liability, weighs all of the many factors affecting the outcome is little understood.<sup>44</sup> Predicting the fact finder's determination becomes even more difficult when the governing law is expressed by a very general phrase such as "negligence is doing something that a reasonably careful person would not do under similar circumstances."<sup>45</sup> Such a standard allows the fact finder to apply the community's values and standards in response to the indeterminate language of the applicable legal standard by characterizing the facts presented in the light of the fact finder's collective experiences.<sup>46</sup> The lawyer's job is to understand and apply the community's standards to the facts of the particular case. Successfully discerning such an amorphous concept is difficult indeed, but those attorneys who best understand people and the societal milieu in which they practice can do it.

Decisions similar to those about liability also must be made about the damages available in a case. The adjustments essentially are an assessment of whether the judge or jury hearing the particular claim will react more or less favorably than the judges and juries in the sampled cases. To a certain extent, this may be the wildest form of conjecture, but, nonetheless, it is possible to compare such aspects as the special damages incurred,<sup>47</sup> the permanency of any injuries, any lost wages suffered, the impairment of future earnings, and so on.<sup>48</sup> When

44. For a review of recent research on jury behavior, see R. MACCOUN, *GETTING INSIDE THE BLACK BOX: TOWARD A BETTER UNDERSTANDING OF CIVIL JURY BEHAVIOR* (1987).

45. See, e.g., *NJ*2d 3.02:

Negligence is doing something that a reasonably careful person would not do under similar circumstances, or failing to do something that a reasonably careful person would do under similar circumstances.

46. G. LILLY, *EVIDENCE* 7-8 (2d ed. 1987); 3 F. HARPER, F. JAMES & O. GRAY, *LAW OF TORTS* § 15.3, at 354-57 (1986).

47. Peterson found the size of jury awards in personal injury cases in Cook County, Illinois, was strongly related to the amount of medical specials. M. Peterson, *supra* note 31, at vi.

48. There is an ample body of practice literature to assist in the comparison, particularly in personal injury cases. For a representative sampling of the literature on the subject, see Wolfstone, *Evaluation and Settlement of Your Case* in II SETTLEMENT TECHNIQUES, No. 2, at 2 (S. Spieser & S. Baldwin eds. 1979); Shayne, *Organizing the Personal Injury File: Increasing the Value of the Case* in EVALUATION AND SETTLEMENT OF PERSONAL INJURY CASES (C. Badway & N. Shayne, co-chairs 1976); Goding, *How a Defendant Evaluates a Case and Sets Up a Reserve* in *id.*; Badway, *An Evaluation Formula; Sample Case for Evaluation* in *id.*; R. HAYDOCK, *NEGOTIATION PRACTICE* § 2.3 (1984); H. BAER & A. BRODER, *supra* note 1; Lee, *Some Comments on Negotiation and Settlement*, 4 AM. J. TRIAL ADVOC. 277 (1980); Nolan, *Settlement Negotiations*, LITIGATION, Summer 1985, at 18; H. HICKAM & T. SCANLON, *PREPARATION FOR TRIAL* (1963); Elam, *Settlement Procedures*, 23 INS. COUNS. J. 602, 602 (1961); Fisher, *Civil Case Evaluation Factors* in NORTH CAROLINA CIVIL NEGOTIATIONS AND SETTLEMENT MANUAL (1985); Beskind, *Damages in Civil Cases* in *id.*; Fuchsberg, *Published by University of Missouri School of Law Scholarship Repository*, 1991

the sampled verdicts have been drawn from another jurisdiction, are dated, or are not sufficiently similar to the particular claim, further adjustments will be necessary. Also complicating the comparison is that, while liability and damages may be separate in theory, in practice the two are related in the jury's considerations; the weaker the proof of liability, the more likely that reduced damages will be awarded in response.<sup>49</sup>

## 2. Methods of Adjustment

Adjusting the distribution is, to a large extent, a judgmental process requiring difficult and complex decisions on what weight to give each of the many factors in a case. Despite or because of that difficulty, the practice literature devotes considerable attention to developing methods of assisting attorneys in making these decisions. For example, Melvin Belli, in his seminal work, *Modern Trials*,<sup>50</sup> presents a point system, allocating points to several categories that influence damage awards in personal injury cases, which points then result in a multiplier to apply to the expected verdict.<sup>51</sup> Several other authors suggest determining a claim's "full" value, that is, the probable verdict for a "perfect" case, and then adjusting this amount by estimated values that reflect the peculiarities of the case.<sup>52</sup> The *Personal Injury Valuation Handbooks*, in the most systematic and empirically based method, present a procedure that adjusts for jurisdictional differences, degrees of liability, quality of opposing counsel, and a number of other factors. Even the commonly used multiplier system of some number times the specials in a case is nothing but a crude method of relating one factor, the specials, to the anticipated verdict.

Multiple issue cases present an attorney with even greater difficulties in predicting the outcome at trial. With most cases, the judge or jury is required to

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*supra* note 14, at 23.

The most thorough scholarly discussion of the factors influencing jury decisions on liability and damages, at least in one jurisdiction, is A. CHIN & M. PETERSON, *DEEP POCKETS, EMPTY POCKETS: WHO WINS IN COOK COUNTY JURY TRIALS* (1985).

Most of the factors to be examined are the same as those noted for determining liability. Much of the literature, surprisingly, does not distinguish as to whether a particular factor is important to an assessment of liability, damages, or both, but merges the two.

49. See Kalven, *supra* note 21, at 165-66; A. CHIN & M. PETERSON, *supra* note 48, at 42 ("[O]ur analyses showed a 'deep pocket effect,' but only if a plaintiff was very seriously injured."); *But see id.* at 36 (plaintiffs' injuries were not strongly associated with liability); M. PETERSON, *supra* note 31, at 38-39.

50. M. BELL, 1 *MODERN TRIALS* § 110, 756-64 (1st ed. 1954). Mr. Belli credits J. Martin Sindell of Cleveland, Ohio, with the development of the formula approach. Mr. Sindell later presented his own version of the formula approach in Sindell, *What Price Personal Injury?*, *THE PRACTICAL LAWYER*, Feb. 1957, at 37, 42-46. Mr. Belli omits the formula from the second edition of his treatise.

51. Another version of the formula approach may be found in Swofford, *Evaluating Damage Claims*, 11 *ARK. L. REV.* 35 (1956-57).

52. See, e.g., Wagner & Wagner, *The Settlement Process: How You Can Prepare for It*, *TRIAL*, Aug. 1984, at 63.

decide only one issue, the essence of which can be stated as, "Is the defendant responsible?" Any disputes in the case are often matters of emphasis to be given the facts and the inferences to be drawn therefrom, rather than conflicting versions of the same event. Arriving at a verdict thus requires a judge or jury to engage in a holistic evaluation of the evidence and to arrive at a decision based thereon.

In more complex cases, the judge's or jury's analysis may be considerably more difficult. Instead of one decision, they may be required to make a series of decisions, each of which may alter the outcome of the case, either as to liability or the damages to be awarded. These decisions may be independent of or dependant on each other, or some combination of both. Obviously the lawyer's difficulty in creating a distribution in such a case is vastly complicated by the number and complexity of the issues involved. Similarly, while the issue to be decided by the judge or jury may be unitary, the likelihood of a decision for or against the plaintiff may depend on the admissibility of several different items of evidence, the credibility of certain key witnesses, the ability to locate and present certain crucial pieces of evidence, and so on. Again, the lawyer, in predicting the outcome of the trial, must account for the different probabilities of each subpart of the proposed proof being received into evidence and its effect on the fact finder.

### 3. Sources of Error

Perhaps the abundance of practitioners' literature on assessing liability and damages can be explained by this also being the aspect of valuation most subject to error.<sup>53</sup> The potential magnitude of error is reflected in a study conducted by Rosenthal, which compares, for sixty personal injury cases, the actual outcome versus the evaluation made by two plaintiffs' lawyers, two insurance adjusters, and one attorney who handled both plaintiffs' and defendants' claims.<sup>54</sup> The variation among the five evaluators and the actual outcomes is startling. In one case, for example, the lowest evaluation was \$2,500, the highest was \$25,000, the mean for the five evaluations was \$10,000, and the actual recovery in the case was \$25,000.<sup>55</sup>

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53. P. SPERBER, ATTORNEY'S PRACTICE GUIDE TO NEGOTIATIONS 704 (1985) ("Most negotiations that fall through, or don't result in settlement, do so because one side has a very different projection of what the jury will do than the other.").

54. D. ROSENTHAL, LAWYER AND CLIENT: WHO'S IN CHARGE? 202-07 (1974).

55. Professor Gerald Williams conducted a similar study by taking 40 practicing lawyers in Des Moines, Iowa, dividing them into twenty pairs, and having them negotiate the settlement of a personal injury case. In preparation for the negotiations, photocopies of comparable jury awards from the Des Moines area were given to both sides. Of the twenty negotiating pairs, 14 reported their results. Of the 14, four failed to reach an agreement. For the remaining 10 pairs, the settlements ranged from \$15,000 to \$95,000. While the study did not report the attorneys' valuation of the case, it can be inferred from the wide range of results that the valuations showed a similar diversity of views. G. WILLIAMS, *supra* note 15, at 5-7.

Another study is found in R. HAYDOCK, *supra* note 48, at section 2.3, where 30 experienced personal injury trial lawyers were asked to evaluate a simulated personal injury case. Predictions of  
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The survey also confirmed the potential for error. When asked why their case did not settle but instead went to trial, the surveyed attorneys gave one side or the other's miscalculation of liability or damages as a reason in sixteen of the twenty-two trials.<sup>56</sup> Caution must be exercised in drawing conclusions from these figures, however. Many times one party stated that the other party miscalculated but did not admit any miscalculation of its own, a conclusion requiring some speculation. Further, the fact that a party won, lost, or achieved a damage award different from that predicted does not confirm there was an error in calculation. If an attorney values a case as having a 75% probability of a plaintiff's verdict, a defendant's verdict is within the prediction given. The valuation would be incorrect only if we could retry the case a number of times and the result was a win/loss percentage different from that predicted. Since in reality this is impossible, it is difficult in hindsight to say that a valuation was incorrect unless the amount of the verdict fell outside the predicted verdict range or the prediction was 100% liability or lack of liability and the verdict turned out the other way. Examples of this were reported in the survey but were uncommon.

Interestingly, several of the surveyed attorneys stated that they deliberately overestimated to their clients the probability of an adverse determination of liability or award of damages. The attorneys quite candidly stated that they did this to protect themselves from criticism of their valuation of the case in the event of an adverse decision. While perhaps deplorable on ethical grounds,<sup>57</sup> such a practice actually encourages settlement by extending the bargaining range beyond what an honest valuation would provide.

Even with these caveats, the number of times miscalculation of liability or damages was given as the reason for a failure to settle leads to the conclusion that it is a significant problem in the valuation of cases.<sup>58</sup> Differences over the

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what percent of liability a jury would place on the defendant in the case ranged from 20 to 90 percent while the estimated damages a jury would award the plaintiff varied from \$12,000 to \$150,000.

The practice literature predicts differences in valuation figures between lawyers of 200 to 300 percent. Wolfstone, *supra* note 48, at 2.

56. Many times more than one reason was given by an attorney as to why settlement did not occur (See Appendix 2.). But miscalculating liability or damages, although not always using those terms, was given 22 times out of the 62 responses obtained to this question.

57. See MODEL CODE OF PROFESSIONAL RESPONSIBILITY EC 7-5 (1977) ("A lawyer as adviser furthers the interest of his client by giving his professional opinion as to what he believes would likely be the ultimate decision of the courts on the matter at hand. . . ."). MODEL RULES OF PROFESSIONAL CONDUCT Rule 1.4(b) (1983).

58. While not reported by any of the surveyed attorneys, there is experimental data suggesting that attorneys are biased in their valuation of cases in favor of the side they represent. Thus, in valuing the same facts, plaintiffs' attorneys will place a greater value on the case than the attorneys representing the defendant. See R. FISHER & W. URY, *supra* note 8, at 58; H. RAIFFA, *supra* note 7, at 75. Other bias sources of error and suggestions for correction are reported in J. HULL, THE EVALUATION OF RISK IN BUSINESS INVESTMENT 50-53 (1980), and D. Kahneman, P. Slovic & A. Tversky, *supra* note 14.

Several economic analyses of settlement posit that trial occurs when one or both sides are excessively optimistic. Wittman, *supra* note 39, at 316; Gould, *supra* note 7, at 288-91; Posner, *supra* note 7, at 417-20; Cooter, Marks & Mnookin, *Bargaining in the Shadow of the Law: A Testable Model of Strategic Behavior*, 11 J. LEGAL STUD. 225, 226 (1982), suggests that it is not optimism that

governing legal rule was given only twice as a reason for the failure to settle. The remaining times, the attorneys were analyzing liability differently or coming up with different estimates of the damages suffered.

In conclusion, Step Two requires the lawyer to adjust the distribution of verdicts in similar claims to reflect the unique facts of the claim being valued. The adjustments may result in a shift upwards or downwards reflecting the more or less favorable facts or governing law of the particular claim. After the adjustments, the lawyer should have arrived at predictions for the case being valued of 1) the probability of liability, and 2) the probability of a verdict being returned at each amount in the verdict range or frequency distribution.<sup>59</sup>

### *C. Step Three: Adjusting the Distribution To Reflect Transaction Costs*

Litigation imposes costs that, if not shiftable to the opponent, will increase the defendant's losses and reduce the plaintiff's recovery. A party valuing a case for settlement therefore must account for what an economist would call "transaction costs." These costs may take several forms, but the most important are: 1) litigation expenses, 2) the time value of money, and 3) any tax consequences of the litigation to the plaintiff or defendant. In addition, while not a transaction cost, the collectability of any judgment as well as any subrogation agreements must be considered. Once calculated, transaction costs must, in general, be subtracted from the break-even point of the plaintiff's case and added to the break-even point of the defendant's case.

The significance of transaction costs in the valuation of a case is directly proportional to the ratio of the anticipated costs to the potential size of any verdict. With smaller claims, transaction costs assume greater significance. The small size of the expected recovery or loss in relation to the costs strongly encourages the

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leads to trial, but the parties' efforts to obtain larger shares of the stakes in a dispute causes settlement to fail.

59. Many lawyers estimate potential liability by placing a percentage probability on the outcome of the trial. Other lawyers prefer not to speak in such precise terms, particularly when their confidence in the prediction's validity is less than sure. These lawyers choose such terms as a "good chance" or "average chance" of a side prevailing. Such ambiguous terms protect the lawyer if ever challenged on the prediction, but their potential for misleading the client is great if, as is likely, the client's understanding of the terms differs from that of the lawyer's. Business clients, in particular, find numerical assertions of probability preferable and easier to work with. Vagts, *Legal Opinions in Quantitative Terms: The Lawyer as Haruspex or Bookie?*, 34 BUS. LAW. 421, 424-25 (1979); A *Businessman's View of Lawyers*, 33 BUS. LAW. 817, 826 (1978).

Lawyers may find it difficult to speak in quantitative terms about subjective probabilities because of an inability to conceptualize the process as calculating a bet. When asked what is the probability of winning, they state they cannot quantify the answer. But when asked if they would rather place a bet on the plaintiff winning the suit or bet on a red ball being drawn from an urn of 50 red and 50 black balls, they find a more ready answer. From there it simply becomes a process of adjusting the proportion of red and black balls until the lawyer is indifferent between the two "wagers." J. HULL, *supra* note 58.

settlement of smaller claims. Similarly, in factually or legally complex cases, transaction costs may be large in proportion to the relief sought, because of the expense of presenting proof, engaging in discovery, or bringing and defending motions, and thus encourage settlement.<sup>60</sup>

### 1. Litigation Expenses

The most important component of transaction costs is litigation expenses, e.g., attorney fees, filing fees, deposition costs, witness fees, and so forth.<sup>61</sup> Of these, attorney fees are usually by far the largest. Some of the costs, such as filing fees, may be shiftable, depending on the jurisdiction, to the opposing party in the event of a favorable verdict,<sup>62</sup> but attorney fees usually are borne by the respective parties, absent a statutory provision or court rule to the contrary.<sup>63</sup> For those litigation expenses that cannot be shifted, the amount must be subtracted from any recovery or added to any loss.<sup>64</sup> The effect of shiftable cost items must be considered in relation to the parties' aversion to risk, a subject discussed in Step Four.

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60. Lambros, *The Judge's Role in Fostering Voluntary Settlements*, 29 VILL. L. REV. 1363, 1367 (1983-84).

61. See generally Swofford, *supra* note 51; G. WILLIAMS, *supra* note 15, at 11.

62. See generally C. WRIGHT, A. MILLER & M. KANE, 10 FEDERAL PRACTICE AND PROCEDURE § 2665 (1983).

63. See generally Symposium, *Attorney Fee Shifting*, 47 LAW & CONTEMP. PROBS. 1 (1984); Shavell, *Suit, Settlement, and Trial: A Theoretical Analysis under Alternative Methods for the Allocation of Legal Costs*, 11 J. LEG. STUDIES 55 (1982); J. SHAPARD, *supra* note 9. The ability to impose processing costs on an opponent becomes an important bargaining chip for the party possessing that ability. Most litigation costs will have a symmetrical effect on the parties, e.g., both parties have to incur attorney fees while their lawyers attend a deposition, but some costs, such as for responding to interrogatories, will fall much more heavily on one of the parties. Perritt, *supra* note 6, at 1288-89. Of course the responding party may retaliate by also propounding interrogatories, thereby, in effect, making the costs equal. Even when the costs are symmetrical, the party with the greatest resources may attempt to break the opponent's "war chest" by imposing costs on the opponent. When the imposition of costs is asymmetrical, the bargaining range will widen to reflect the increased costs of the burdened party.

Even though litigation costs might be shiftable, the present ability to finance the costs of litigation will determine whether a party continues to pursue a claim. By the same token, while the time value of money may be precisely calculated, if the party has an overwhelming need for funds at the present and is unable to acquire funds from other sources, this provides a powerful bargaining chip to the opponent. These considerations are not transaction costs, but are calculated in Step 4, *infra* notes 106-08 and accompanying text.

64. If costs are shiftable, the result is to shift the bargaining range of the parties so that, if the defendant will assume the plaintiff's costs, the plaintiff's recovery is increased by the same amount as the increase in the defendant's loss. The extent of the bargaining range will also change to reflect the estimated probabilities of recovery. Note, *supra* note 7, at 72-73; Phillips & Hawkins, *Some Economic Aspects of the Settlement Process: A Study of Personal Injury Claims*, 39 MOD. L. REV. 497, 501 (1976).

Wittman states that the greater the cost of trial relative to the cost of settlement, the greater the likelihood of settlement. Wittman, *supra* note 39, at 319. This follows from the proposition that the greater the cost of trial in relation to settlement, the greater the parties' bargaining range.

Thirteen of the surveyed attorneys, approximately a third of the total, listed litigation expenses as a factor they take into account when valuing a case for settlement. The number reporting this as of importance is probably lower than the actual number, for several reasons. First, factors generally were not suggested to the attorneys during the survey; the attorneys were encouraged to give their own approach to valuation without prompting. As a result, many were probably less than complete in their responses. Second, because most of the personal injury cases were relatively simple, litigation expenses, aside from attorney fees, were not likely to be particularly burdensome in relation to the potential verdict. Third, the plaintiffs in personal injury cases most frequently were represented on a contingency fee basis so that the client would have no obligation for attorney fees. Fourth, modern litigation has become so time-consuming, primarily because of discovery, that attorney fees cannot be lightly disregarded in any intelligent valuation of a case. Lawyers as well as the public have now become so familiar with the impact such fees have on the net gain or loss in a case that even the first-time consumer of legal services is fully aware of the effect of litigation expenses on the net gain or loss from a judgment.

An unmonetized litigation expense and one frequently unaccounted for in the valuation process is time. A deposition or trial requires a party's time, time that could be used in running a business, caring for a family, or pursuing other matters presumably more worthy than litigation.<sup>65</sup> Although potentially a difficult procedure, monetizing time requires estimating the number of hours the party expects to devote to the litigation and then asking the party what monetary amount it would be willing to pay to avoid having to give up that time. The value placed on the time is a transaction cost that settlement can avoid incurring.

Three of the surveyed attorneys mentioned time demands on their clients as a factor they took into account when valuing the case for settlement. All of the cases in which this was mentioned were contract disputes, in which clients typically are charged on an hourly or set fee basis. With personal injury claims, plaintiffs usually are represented on a contingency basis that gives the attorney a financial interest in the outcome of the case, while the defendant's attorney is in most instances paid by and beholden to an insurance company. Not surprisingly, then, personal injury cases offer little incentive for the attorneys for either party to take into account any time costs, but in contract cases the opposite is more likely to hold true.

Litigation expenses, both monetized and unmonetized, are incurred throughout the course of the litigation but at a nonuniform rate. Many costs will be "sunk" by the time of any settlement negotiations, but not necessarily proportionally to the time remaining until trial. Because they have already been incurred, sunk costs, under rational economic behavior, should not have any effect on the break-even point of the case unless they are shiftable. Nonshiftable costs, such as attorney fees, will never be recoverable once incurred, and therefore

65. G. WILLIAMS, *supra* note 15, at 10-11.



should not affect a party's break-even point, although they may affect a party's decision to accept or reject a settlement offer.<sup>66</sup>

Litigation costs tend to "spike" just before and during any major event in the litigation, such as the taking of depositions, a major motion, or trial. Although sunk costs should not affect a party's break-even point, there is an incentive to avoid incurring these costs by reaching a settlement before the spike. The possibility of avoiding litigation costs has no effect on the break-even point, since the point assumes that all such costs have been incurred. However, before the spike, any settlement offer will be more attractive in comparison to the break-even point, because the party's surplus over the break-even point will be increased by the amount of the avoided costs.

## 2. Time Value of Money

The second category of transaction costs is the time value of money.<sup>67</sup> Quite simply, money in hand is worth more than the certain promise of money in the future. Money in hand can be used and invested to provide a return. When there is any anticipated period of delay between the time of the first opportunity to settle the claim and its ultimate resolution, the amount of any future recovery must be discounted to reflect its present value at the time when the claim could be settled.

A way of illustrating this concept is to imagine a note for \$10,000 payable on January 1, 1992. On the due date of the note, it should be worth the amount of the sum due, presuming there is no question about the willingness of the payor to honor the note and no transaction costs attendant to its collection. But no rational person would today pay \$10,000 for the note, since they would not be able to obtain the money until the due date of the note and would be deprived from now and until then of the use of the sum they paid for the note. Although not worth \$10,000 now, the note unquestionably has value, but how much it is worth is difficult to say.

The present value of a sum due in the future is obtained by applying a discount rate to the future sum. The appropriate discount rate to be applied is an issue subject to considerable debate and probably beyond any definitive

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66. See *infra* note 95 and accompanying text. The cost of settlement, that is, the attorney's and party's time and resources devoted to arriving at a settlement, also can be viewed as a transaction cost and should be taken into account. Since the cost of settlement can be avoided by proceeding to trial, it should be added to the plaintiff's expected recovery and subtracted from the defendant's expected loss when computing the value of a case. Note, *supra* note 7, at 73-74. In reality, such costs are usually so insignificant in relation to the magnitude of the expected recovery that they are ignored in practice. Such, however, may not always be the case.

67. Swofford, *supra* note 51, at 285; G. WILLIAMS, *supra* note 15, at 120-27. For a theoretical discussion of this subject, see Posner, *supra* note 7, at 420-22.

resolution.<sup>68</sup> Complicating the matter further is that the rates may be different for the plaintiff and defendant. A typically used discount rate for the plaintiff is the interest rate at which the plaintiff can borrow the sum in question. On the other hand, an appropriate rate for the defendant may be the rate of return the defendant can obtain through alternative uses of the money, such as purchasing an annuity.<sup>69</sup> If the defendant currently does not have the necessary funds to pay the expected judgment, then the rate would be the interest rate at which it could obtain a loan. Each one of these rates may differ. For valuation purposes, however, a lawyer need only be concerned with the discount rate applicable to his client. Once determined, that rate must be applied to any anticipated verdict to arrive at its present value.

Surprisingly, only one of the surveyed attorneys mentioned the time value of money as a factor in valuing a case. This may be in large part because claims in Lancaster County are usually without difficulty brought to trial within one to two years of filing. Since the time value of money becomes important only in comparing a settlement offer and the anticipated outcome of trial, the period over which it must be computed is from the point of the offer to verdict. Since many times an offer is not made until some time after filing, the period may be quite short. Particularly then with smaller claims, the time value of money is not of great significance.

Unlike litigation costs that adversely affect both sides to the extent they are not shiftable, the time value of money shifts the plaintiff's and defendant's break-even points in the same direction by decreasing the present value of the amount the plaintiff will recover and the defendant will lose. Thus, unless such costs can be shifted, defendants have a strong incentive to delay the resolution of claims to the extent possible.<sup>70</sup> In recognition of this, many jurisdictions have attempted to shift the time value costs of money to the defendant through prejudgment interest rules and statutes.<sup>71</sup>

68. See G. WILLIAMS, *supra* note 15, at 127; Mead, *Calculating Present Value*, TRIAL, July 1984, at 16. Cooter, Marks and Mnookin state that an increase in the discount rate will increase the likelihood of settlement. Cooter, Marks & Mnookin, *supra* note 58, at 238. The effect of other changes on the probability of settlement are discussed in *id.* at 238-41.

Another factor that influences the discount rate is the expected rate of inflation. See Harris, *Inflation Risk as Determinant of the Discount Rate in Tort Settlements*, 50 J. RISK & INS. 265 (1983).

69. Since it is unlikely that these rates will be the same, the effect on the break-even points of the parties and, in turn, the bargaining range, will be unequal. Posner, *supra* note 7, at 420-21.

70. Kelner, *Settlement of Personal Injury Cases*, 53 N.Y.ST.B.J., Feb. 1981, at 116, 117; Note, *supra* note 7, at 78-79. Insurance companies frequently are accused by the plaintiffs' bar of delaying the payment of claims so as to permit the continued investment of the funds at issue; a claim that is vehemently denied by the companies. See, e.g., Shayne, *The Settlement of Personal Injury Actions*, in EVALUATING CASES 1982 13, 15 (N. Shayne, chair 1982); H. ROSS, *supra* note 14, at 85, 140, 166.

71. See, e.g., NEB. REV. STAT. § 45-103.02 (Reissue 1988). Posner argues that prejudgment interest statutes decrease the likelihood of settlement by decreasing the bargaining range of the parties. Posner, *supra* note 7, at 421.

### 3. Taxes

The third category of transaction costs is the tax consequences accorded litigation expenses and any verdict.<sup>72</sup> An important issue for any plaintiff is the tax treatment an expected recovery will receive. The defendant similarly is concerned with the deductibility of any judgment against it. Each also must be concerned with the deductibility of any litigation expenses in arriving at the true cost of pursuing or defending a case.<sup>73</sup> The underlying nature of the claim determines the tax consequences, which in turn are determined by the pleadings and the issues and evidence presented.<sup>74</sup> As an example, if a plaintiff sues for and obtains a judgment for wrongful discharge, claiming lost wages, injury to reputation, and emotional injury as damages, each item of damage may receive a different tax treatment. The lost wages are in the nature of income and taxable as such.<sup>75</sup> Judgments for personal rights such as emotional injury and injury to reputation are not treated as income and therefore are not taxable,<sup>76</sup> but when the injury is to professional reputation, this is in the nature of lost wages and thus is income.<sup>77</sup>

Presumably the settlement of a claim should receive the same tax treatment as a resolution through trial and verdict, and generally this is so. However, the parties may be able to alter these consequences through specifying that the settlement is in satisfaction of particular items of damage that have different tax consequences than other items designated as being dismissed.<sup>78</sup> When the parties are able to alter the tax consequences to each side, this may become the subject of intense negotiation.<sup>79</sup> A further area of negotiation may be the timing of any payments, since this may determine in which taxable year a settlement is treated as income or a deduction, when the amount of payment may place the recipient in a higher or the payor in a lower tax bracket.

Tax liability only becomes important in valuing a case when the liability for a verdict differs from that accorded a settlement. The tax liability imposed on any

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72. G. WILLIAMS, *supra* note 15, at 132-35; H. HICKAM & T. SCANLON, *supra* note 48, at 240; Potter, *Settlement of Claims and Litigation: Legal Rules, Negotiation Strategies, and In-House Guidelines*, 41 BUS. LAW. 515, 525 (1986).

73. For example, legal services are deductible expenses if incurred as part of the taxpayer's business, Treas. Reg. § 1.162-1 (1988), or in pursuit of defense of a claim for damages qualifying as taxable income, I.R.C. § 212 (1988).

74. See, e.g., *Niles v. United States*, 520 F. Supp. 808, 813 (N.D. Calif. 1981), *aff'd sub nom. Niles By and Through Niles*, 710 F.2d 1391 (9th Cir. 1983).

75. *LaPointe v. Commissioner*, 43 T.C. 871, amended, 43 T.C. 903 (1943).

76. *C.A. Hawkins*, 6 B.T.A. 1023 (1931).

77. *Wallace v. Commissioner*, 76 T.C. 941 (1976).

78. See *O.S.C. Corp. v. Commissioner*, 82 T.C. 941 (1982).

79. A typical example of this type of bargaining occurs in divorce proceedings, in which alimony is deductible from gross income by the payor and is treated as income to the recipient. I.R.C. §§ 71(a), 215(a). Child support, on the other hand, is not deductible by the payor nor taxable to the recipient. I.R.C. § 71(c)(1). As a result, intense negotiations can occur over whether to treat payments by one spouse to the other as alimony or child support.

judgment will alter the net recovery to the plaintiff and the net loss to the defendant, and a settlement in most instances will be treated in the same way. But when the tax consequences of a settlement are potentially different from those of a judgment, it is necessary to determine the net recovery or loss resulting from a verdict to arrive at the break-even point or settlement value of the claim against which the proposed settlement must be measured. Interestingly enough, none of the survey respondents mentioned tax consequences as a factor taken into account in valuing cases for settlement.

#### 4. Collectability and Subrogation

While not actually a transaction cost, the collectability of any judgment also must be accounted for in valuing a case. When the defendant is without sufficient assets, whether in the form of insurance coverage or other property, to pay a judgment, this serves as a limit or cap on the value of the case.<sup>80</sup> Only two of the surveyed attorneys mentioned insurance limits as a factor in valuing a case. This probably understates the true number who take insurance limits into account, since, in all but one of the surveyed personal injury cases, the amount at issue was well within any possible insurance limits or there was no issue as to the ability of the defendant to pay any judgment against it.

Another limit on the net value of a case that is not actually a transaction cost, but which has the same effect, is the existence of a subrogation agreement between the plaintiff in a personal injury action and a medical provider or insurance carrier, when the plaintiff otherwise would not be obligated to pay such expenses. Any anticipated recovery by a plaintiff in such a case must be discounted by the required payment to the carrier or provider. An offsetting aspect to any subrogation agreement is the requirement that the carrier or provider generally must contribute to litigation expenses as a condition of receiving payment. Again, the effects of a subrogation agreement should be the same on a settlement and a verdict. Realistically, however, plaintiff's attorneys usually negotiate a discount of the subrogation claim as a precondition to settling a claim.

Only one of the surveyed attorneys reported that subrogation agreements were a significant factor in valuing the case for settlement purposes. With that case, the amount available to the plaintiff was so small, after deducting the subrogated medical expenses from the proposed settlement, that the plaintiff thought it was worth gambling on a larger verdict even though liability was evaluated as weak.

Once the transaction costs for a case have been computed, the break-even point must be adjusted to reflect these costs. Usually the adjustment will be to decrease the net recovery by the plaintiff and increase the net loss to the defendant, but each item of cost must be examined individually. Some items, such as the time value of money, may have the opposite effect for a defendant, or an item may be shiftable to the opponent in the event of success. Subrogation agreements decrease the plaintiff's break-even point by reducing the net recovery

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80. Swofford, *supra* note 51, at 285.

but have no effect on the defendant's break-even point. Collectability of a judgment places a cap on the break-even point.

Incorrectly estimating the costs is the greatest source of difficulty in valuing the effects of transaction costs on the settlement value of a case. Ironically, an overestimation of transaction costs actually enhances the prospects for settlement by widening the bargaining range of the parties. But the opposite occurs with an underestimation of transaction costs, causing settlement to become more difficult or even impossible.

None of the respondents in the survey gave the miscalculation of transaction costs as a reason for the failure to settle a case, but it is difficult to know why this was so. It could be that no miscalculations occurred, that the attorneys were unaware that errors in calculation were made, or that any errors made did not significantly affect the decision to proceed to trial. A more detailed analysis of the valuations made in each case would be necessary to answer this question.

In conclusion, Step Three requires the lawyer to adjust the verdict range or frequency distribution arrived at in Step Two to reflect expected transaction costs of litigation expenses, the time value of money, and any differences in the tax treatment of a settlement and verdict. In addition, the amounts must be further adjusted to reflect any limitations on the collectability of a judgment and any subrogation agreements.

#### *D. Step Four: Selecting a Break-Even Point Reflecting The Client's Preferences and Values*

To this point, the valuation process will have resulted in a verdict range or frequency distribution that accounts for the unique facts of the particular case and expected transaction costs. But litigation is not a purely economic process. It also entails psychological, social, and legal consequences, as well as economic effects not reflected in the preceding calculations. These consequences may affect the client in ways extending well beyond the confines of the immediate litigation.

A verdict range or frequency distribution does not tell the client or lawyer at what amount a case should settle nor even whether it should settle at all. The revised distribution is only a predictive device indicating possible outcomes at trial. It helps a client decide at what point it should be indifferent between settlement and trial, but the decision also will be based on the social, psychological, and legal, as well as the economic, consequences of settlement and trial and on how the client values each one of these consequences. Because these evaluations are unique to each client, one cannot extrapolate from other cases to the preferred result in the particular case. Only the client can value and weigh these issues, a position reflected in the Code of Professional Responsibility's insistence that it is for the client to decide whether to accept a settlement offer.<sup>81</sup>

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81. MODEL CODE OF PROFESSIONAL RESPONSIBILITY EC 7-7 (1977); MODEL RULES OF PROFESSIONAL CONDUCT Rule 1.2(a) (1983).

The importance of the client's preferences and values cannot be over-emphasized. In sixteen of the twenty-two surveyed cases that proceeded to trial, client preferences and values were listed as at least one of the reasons settlement did not occur. In other words, trial resulted not because of some error in the valuation process, but because one party or the other valued some consequence of trial or settlement more highly than the best proposed settlement.

### 1. Risk

The consequence of litigation most influencing a client's choice of settling or proceeding to trial is risk: the risk of losing. Each individual reacts to risk differently, depending on myriad factors, including psychological makeup, the magnitude of the risk, the benefits of certainty, the benefits of a favorable result, and the consequences of an adverse result. Settlement brings with it certainty, but at the price of forgoing the opportunity to achieve a greater gain or smaller loss. Whether a client should accept a settlement proposal or proceed to trial depends on that client's propensity or aversion to risk; that is, how willing the client is to gamble on the outcome of trial versus the certainty of settlement.<sup>82</sup>

The degree of risk averseness varies not only from individual to individual but also through time and from situation to situation for the individual. Most persons, for instance, become more risk-adverse as the amount at issue increases. A plaintiff willing to roll the dice and go all or nothing for a claim of several thousand dollars is much less likely to make the same gamble when several million dollars are at issue. Similarly, a wealthy individual is, as a rule more willing than a welfare mother to gamble on a claim of under a thousand dollars. In short, propensity or aversion to risk much depends on the particular economic circumstances of the individual as well as that person's psychological predisposition to risk.<sup>83</sup>

Risk averseness becomes important when the client confronts a settlement offer and must decide whether to accept it or reject it and go to trial. Then the client must decide what concessions to make to achieve the certainty of settlement and avoid the possibility of an unfavorable trial outcome. For example, in an intersection collision case, the plaintiff may expect a \$10,000 verdict with a fifty percent probability of recovery. When confronted with a final settlement offer of

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82. Kelner, *supra* note 70; G. WILLIAMS, *supra* note 15, at 11, 130-31. For a theoretical discussion of the effects of attitudes to risk, see Gould, *supra* note 7.

83. See generally W. VAN RAAIJ, G. VAN VELDHoven & K. WARNERYD, *HANDBOOK OF ECONOMIC PSYCHOLOGY* 379, 424-30 (1988); Kahneman & Tversky, *Prospect Theory: An Analysis of Decision Under Risk*, 47 *ECONOMETRICA* 263 (1979) (The authors present studies of how individuals react to risk and offer a theory of behavior). The text discussion is concerned with the reaction of individuals to risk, but there is evidence that organizations, e.g., corporations, assess risk differently than individuals because of the different psychological dynamics occurring with group decision making. See Tomkins, Victor & Adler, *Psychological Aspects of Organizational Behavior: Assessing and Controlling Risk* in *HANDBOOK OF PSYCHOLOGY AND LAW* (D. Kagihiro & W. Laufer eds.) (forthcoming).

\$8,000, the plaintiff must choose the certainty of the \$8,000 settlement or go to trial with a fifty/fifty chance of achieving from nothing to \$10,000. The plaintiff's choice will depend on the plaintiff's degree of aversion to risk.

In exactly half of the twenty-two surveyed cases that proceeded to trial, the willingness of one party or the other to gamble on a more favorable outcome than the best settlement offer was listed as at least one of the reasons for a failure to settle. As would be expected, the effect of risk aversion was highly context-based, thereby giving rise to only the broadest possible generalizations. For instance, the amount of "exposure", that is, the estimated small size of an adverse verdict, influenced several insurance carriers to gamble on a favorable verdict at trial. Similarly, several plaintiffs were willing to go to trial gambling on a large verdict, even though potential liability was weak, rather than settle for a comparatively small amount. Interestingly, four of the defendants stated they did not have the resources to pay the plaintiffs' proposed settlement offer, and gambling on a favorable outcome at trial was their only option.

While risk was listed as one of the reasons for a failure to settle in half of the surveyed cases, it is necessarily implicit in all of the cases. Even though other reasons were given in the remaining cases, it must be reasoned that the risk of an adverse verdict was not perceived as great enough to outweigh the other consequences of trial—which is not to say that risk averseness has no significance. At some level, every person will account for risk as a factor in the ordering of his or her affairs.

Risk aversion not only affects the amount at which a case is settled, but also the timing of any settlement. It is common knowledge among trial attorneys that serious settlement discussions often do not begin until the eve of trial, and there are many tales of settlements made literally on the courthouse steps.<sup>84</sup> One study found that the worth of a personal injury case may increase as much as 20%, just before the trial, over its value two years before.<sup>85</sup> The explanation for this phenomenon is, among other things, risk exposure.<sup>86</sup> When a trial is two years away, the consequences of an adverse decision are thought remote and abstract. However, as the trial date approaches, the consequences become more apparent and pressing. As a result, parties are willing to pay more or accept less as trial approaches.<sup>87</sup>

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84. See Lambros, *supra* note 60, at 1370.

85. D. WATERMAN & M. PETERSON, *EVALUATING CIVIL CLAIMS: AN EXPERT SYSTEM APPROACH* 8 (1985).

86. Professor Gould argues that, as the trial date approaches and each party gains a clearer understanding of the other party's case, the differences in their estimates of the outcome of the trial will narrow or disappear, thus facilitating settlement. Gould, *supra* note 7, at 287. This explanation, however, does not account for the high number of settlements that occur within days or hours of the commencement of trial. See discussion, *infra* note 87.

87. Several other explanations can be made for the rapid increase in value as trial approaches. Some amount of increase can be attributed to the time-price value of money. See *supra* notes 67-71 and accompanying text. Second, by the time of trial, there will be many more sunk costs that many attorneys will seek to recover through settlement. See *infra* notes 94-96 and accompanying text. Third,

Despite its importance to the settlement of cases, risk aversion frequently is ignored in both the scholarly and practice literature. For example, several analyses of negotiation theory postulate that the settlement value of a case is its expected value.<sup>88</sup> Expected value is arrived at through multiplying the anticipated verdict by the probability of liability.<sup>89</sup> In other words, if the anticipated verdict in the case is \$10,000 and the estimated probability of liability is 80%, then the expected value is \$8,000. From this, it is concluded that the settlement value for the case is \$8,000.

This is a correct analysis for those litigants who are repeat players. It makes sense, for instance, for insurance companies to settle at expected value since, if the cases proceeded to trial, the verdicts will average out to expected value over time, assuming the estimations of liability and damages are correct.<sup>90</sup> However, this is not similarly true for one-time players. The plaintiff in a personal injury case can reasonably anticipate playing the game only once; this will be the only time the plaintiff litigates this or most likely any other claim. Thus, if the case goes to trial, the plaintiff either wins or loses. The plaintiff will not be able to average its wins and losses out over time to achieve the expected value of the case. To make the illustration more graphic, the plaintiff at the conclusion of trial will have either \$10,000 or nothing. Expected value means nothing to the one-time player.<sup>91</sup>

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as trial approaches, the lawyers for both sides will be facing the prospect of intense preparation, with its attendant costs that can be avoided by settlement. See *supra* note 66 and accompanying text. Fourth, attorneys who are busy or otherwise unprepared or psychologically adverse to going to trial may place great pressure on clients who would otherwise find a proffered settlement unacceptable. The effect of the third and fourth factors also may decrease value, depending on which side is more greatly affected. Particularly in negligence actions where a community based standard is being applied, the parties may prefer to wait until a jury is selected before predicting the outcome of the case. Finally, and I suspect most importantly, there is little incentive for a defendant to seriously pursue settlement until the approach of trial, given that, in the absence of cost-shifting statutes, alternative uses can be made of the funds in question. There is also a possibility plaintiff's witnesses will die or disappear or otherwise be unavailable for trial. At a minimum, memories will fade and events be less vivid. While these difficulties may afflict both sides, the party with the burden of proof is likely to suffer most. Nolan, *supra* note 48, at 17; Posner, *supra* note 7, at 420-21. Therefore, the defendant rationally will settle only if given a "bargain rate." See Wolfstone, *supra* note 48, at 6; Shayne, *supra* note 70, at 15.

88. See, e.g., C. CRAVER, *supra* note 8, at 40; Perriitt, *supra* note 6, at 1249; Note, *supra* note 7, at 75-76; Schneider & More, *A Positive Approach to Tort Settlement*, PRAC. LAW., March 1971, at 27; R. SIMMONS, *WINNING BEFORE TRIAL* 1715-18 (1970).

89. When the expected verdict is represented by a range of verdicts, expected value is found by calculating an average or mean verdict.

90. See Wolfstone, *supra* note 48, at 9-10. See also Galanter, *Why the "Haves" Come Out Ahead: Speculations on the Limits of Legal Change*, 9 L. & SOC'Y REV. 95, 99-100 (1974); H. ROSS, *supra* note 14, at 214; Tersine & Johnston, *The Mathematical Evaluation of Trial Versus Settlement*, 594 INS. L. J. 381 (1972).

91. Phillips & Hawkins, *supra* note 64, at 504-05. Ross found that insurance claims adjusters recognized this and expected claimants to accept less than the expected value of a claim. H. ROSS, *supra* note 14, at 215, 241. But see J. ROLPH, 1 *AUTOMOBILE ACCIDENT COMPENSATION: WHO PAYS HOW MUCH HOW SOON?* 26-27 (1985).



While expected value is important to repeat players, even they prefer to avoid what is known as a "wild card" verdict. Juries do not always operate according to predicted verdict ranges or frequency distributions, mean and mode verdicts, or probabilities of liability. When a societal-based standard of reasonableness is applied to determine liability or a subjective measure of damages is used to calculate damages, juries occasionally act unexpectedly by either finding liability when there is little support for such, finding no liability when the evidence is nearly overwhelming, or arriving at a very high or very low damage award. Even repeat players are usually willing to pay something to avoid the small probability of a wild card verdict.<sup>92</sup> Attorneys operating under a contingency fee arrangement also are influenced by risk aversion to the extent that they can influence or even control the decision to settle or proceed to trial. Most contingency fee plaintiffs' attorneys in personal injury cases expect to receive at least a nuisance value offer of settlement from the defendant's insurance carrier to compensate for forgoing the potential of a wild card verdict. If denied this minimal figure, many of these attorneys will proceed to trial to justify their credibility and to play the long shot of a plaintiff's verdict.<sup>93</sup>

As previously noted, risk averseness usually declines as the amount achieved by selecting the certain outcome declines. Thus, when the net return to a plaintiff from a settlement offer is small because of a subrogation agreement or high litigation expenses, the plaintiff is more likely to gamble on the outcome of trial.<sup>94</sup> The same is true for attorneys representing plaintiffs on a contingency fee basis (and able to influence their clients' decision to settle or try a case) when a large percentage of the fee coming from settlement will be consumed by unreimbursed litigation expenses.<sup>95</sup> When an attorney has invested substantial resources in the development of a case and the client cannot realistically be looked to for payment, it may make sense to the attorney to try the case in hopes of

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92. See Franklin, Chanin & Mark, *supra* note 35, at 20; Gifford, *supra* note 12, at 84; Wolfstone, *supra* note 48, at 9; Goding, *supra* note 48, at 66; H. ROSS, *supra* note 14, at 199-204. When the repeat player is the insurance carrier for the defendant, a further calculation must be made if there is a possibility that a verdict could exceed policy limits, thereby exposing the carrier to the potential for a bad faith claim. To avoid this possibility, as with the wild card verdict, the carrier may pay more than the expected value of the case. *Id.* at 71.

93. For an interesting discussion of the behavior of attorneys who do determine whether to settle or try disputes, see Coffee, *Understanding the Plaintiff's Attorney: The Implications of Economic Theory For Private Enforcement of Law Through Class and Derivative Actions*, 86 COLUM. L. REV. 669 (1986).

94. See *supra* note 87.

95. While nonshiftable "sunk" costs do not alter a party's break-even point, they do affect the net return from a settlement or verdict and therefore should be considered when comparing a settlement proposal with the break-even point. The incursion of nonshiftable costs by either side also decreases the bargaining range of the parties thereby making settlement less likely. See J. SILAPARD, *supra* note 9, at 32.

recovering the investment through a wild card verdict, rather than settling for a token amount.<sup>96</sup>

Fee shifting statutes also influence a party's risk averseness. When a party is responsible for its own litigation expenses, this amount must be incorporated into the break-even point. However, when in a fee shifting jurisdiction, the party will be able to avoid incurring its own costs if it wins or will be forced to bear not only its own costs, but its opponent's as well in the event of a loss. The probability of either outcome is the same as the probability of the predicted verdicts assuming there is no discretion by the court in awarding costs. What effect fee shifting has on a party's break-even point, therefore, is dependent on the risk averseness of the party. If a party predicts a favorable outcome at trial and is risk-prone, then the ability to shift fees will increase its break-even point while the converse holds true for a pessimistic, risk adverse litigant.<sup>97</sup>

## 2. Motivations to Settle

Clients, in deciding to settle or proceed to trial, are influenced by many factors unrelated to the risk of an adverse result at trial. Humans are not merely economic machines motivated solely by reasons of profit and loss; social, psychological and legal factors, including ideals, friendships, self-image, psychological needs of acceptance, etc., may make either trial or settlement more attractive than its alternative.<sup>98</sup> The event of trial, in particular, may bring with it many perceived negative consequences that can be avoided by settlement. For many clients, the most important of these is avoiding the emotional consequences of proceeding to trial. It cannot be overestimated how disquieting an experience the prospect of trial is for most individuals. Litigation, with its contentiousness and inherently adversarial nature, keeps many individuals in a constant state of emotional turmoil to the point that the litigation becomes life's dominant concern.<sup>99</sup>

The emotional costs of litigation not only are imposed on the parties but also may be borne by others connected to the parties. In addition to the time demands that litigation may make on a company's resources, the involvement of affected employees may have a disrupting effect on their job performance well beyond the mere number of hours diverted to the case. In divorce, the conflict between

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96. Galanter, *supra* note 30, at 30. Clients who are proceeding on a contingency fee basis, thereby avoiding most transaction costs, also may be willing to proceed to trial in the face of a small settlement offer. With a sense of little to lose by rejecting the proffered sum, they are willing to play the long shot of trial. This becomes particularly true when the bulk of any recovery would be consumed by subrogated creditors.

97. See J. SHAPARD, *supra* note 9, at 38.

98. See Fisher, *Beyond Yes*, 1 NEGOTIATIONS 67, 69 (1985).

99. See Magana, *supra* note 1, at 643 ("Often an aged person doesn't want and can't stand the rigors of litigation."); I. AUNET, HOW TO PROVE DAMAGES IN PERSONAL INJURY AND WRONGFUL DEATH CASES 46 (1973) ("The average client wants to settle rather than to go through what is for him the ordeal of trial."); Nolan, *supra* note 48, at 18.

husband and wife may extend to the emotional well-being of their children. The avoidance of this emotional strife is a sufficient reason in many clients' minds for bringing litigation to a close through a negotiated settlement.

Another emotional expense of litigation, closely related to but different from risk aversion, is the imposition of ambiguity and a party's corresponding desire for certainty. Individuals have varying degrees of tolerance for ambiguity in their lives. It is not so much the possibility of an adverse consequence at trial that causes distress, but the lack of certainty and definiteness in their personal or business affairs. Many individuals and businesses are willing to pay more or accept less to achieve certainty through settlement.<sup>100</sup>

By avoiding much of the emotional turmoil and ill feelings generated by a trial, settlement may be more conducive to maintaining a long-term relationship when that is the parties' objective. The parties to a divorce involving children and visitation, through either necessity or desire, must maintain some degree of relationship after the decree is entered. With a dispute between two businesses, it may be that litigation is necessary to resolve the immediate conflict, but the parties have no desire to otherwise alter an ongoing relationship. In such situations, a party may choose to offer more or accept less in settlement than could otherwise be achieved through trial, in order to preserve the relationship.<sup>101</sup>

Another advantage of settlement is the process of negotiation with its lack of formal rules; settlement is much more informal than litigation, bringing with it less stress on the parties.<sup>102</sup> By the same token, settlement negotiations make use of different skills and tactics than does trial.<sup>103</sup> One party may be more proficient in these skills and therefore more anxious to capitalize on this advantage by pushing harder for a negotiated resolution to the dispute.

While settlement is often presented as a purely economic calculation, many parties prefer a negotiated settlement because of a recognition of wrong doing on their part and a desire to be fair and make recompense.<sup>104</sup> Litigation, with its all or nothing approach to resolution by trial, may seem to the parties not to provide as fair an outcome as a negotiated settlement. For instance, the parties may agree that while both are at fault, the defendant bears the greater degree of responsibility for an accident. But the law may bar any recovery by the plaintiff,

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100. Wall, Schiller & Ebert, *Should Judges Grease the Slow Wheels of Justice? A Survey on the Effectiveness of Judicial Mediator Techniques*, 8 AM. J. TRIAL ADVOC. 83, 87 (1984); H. ROSS, *supra* note 14, at 138.

101. See Magana, *supra* note 1, at 647.

102. G. WILLIAMS, *supra* note 15, at 11; H. ROSS, *supra* note 14, at 138.

103. Not only can different skills and tactics be used, but non-legal arguments can be advanced and interest accommodated that are not recognized by the law; facts can be determined without resort to formal proof and the restrictions of the laws of evidence; and more control exists over the course of the negotiation. Eisenberg, *supra* note 36, at 657-59.

104. "[M]any people who commit offenses to persons or property feel a moral obligation to correct the wrong." G. WILLIAMS, *supra* note 15, at 13. See H. ROSS, *supra* note 14, at 235; Engel, *Cases, Conflict, and Accommodation: Patterns of Legal Interaction in a Small Community*, 1983 AM. BAR FOUND. RES. J. 803, 854.

despite the defendant's greater culpability, because of the plaintiff's contributory negligence. In such a situation, the defendant may still choose to pay some portion of the plaintiff's damages, out of a sense of decency and fairness.<sup>105</sup> A fair settlement offer, if nothing else, usually will gain the good will of an opponent.<sup>106</sup>

In Step Three, it was noted that the time value of money is the recognition that a verdict in the future must be discounted to account for the lost opportunity of earning a return on the money from the present until the time of payment. However, it should be remembered that parties do not always adjust their needs to impersonal markets. A plaintiff with a claim for a large sum may perfectly well understand the time value of money, but this will provide little comfort if she is unemployed and with creditors pressing her and her family. In that situation, the plaintiff may be willing to settle for an amount substantially less than the figure arrived at by discounting the verdict to reflect current payment.<sup>107</sup> In contrast, the need for a large sum of money was one of the reasons given for the plaintiff in one of the surveyed cases proceeding to trial rather than accepting the comparatively smaller amount offered in settlement. Similarly, a defendant who realizes that it will be able to pay in settlement an amount considerably less than the predicted verdict may nevertheless choose to proceed to trial because of current needs for the same funds.<sup>108</sup> This was the reason given by four of the surveyed defendants for refusing to settle, although in their cases it was not a need for the funds, but a lack of funds that compelled them to proceed to trial.

Settlement also can avoid the unwanted publicity of a trial, a matter particularly important to public figures, professionals, manufacturers, and others with reputations to maintain or with confidential information that might otherwise be revealed at trial.<sup>109</sup> Even if the fact of settlement is public knowledge, the terms of the settlement may still be kept confidential.<sup>110</sup> On the other hand, if the dispute already has resulted in publicity, one side or the other may feel constrained to pursue the matter to judgment to dispel any negative pretrial publicity effects.

Outside pressures, such as the need of an insurance adjuster to close cases or pressure from the court to avoid trial, also may encourage settlement. Finally,

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105. Schwarzer, *Managing Civil Litigation: The Trial Judge's Role*, 61 JUDICATURE 400, 407 (1978) ("Increasingly, lawsuits bring into the courts controversies that require problem solving and mediation rather than conventional legal decisions. In cases involving civil rights, the environment and other social issues, disputes may at times be resolved more satisfactorily through mediation rather than trial."); Rosenberg, *Resolving Disputes Differently: Adieu to Adversary Justice?*, 21 CREIGHTON L. REV. 801, 814 (1988); Wall, Schiller & Ebert, *supra* note 100, at 87; Peritt, *supra* note 6, at 1246; G. WILLIAMS, *supra* note 15, at 11; H. ROSS, *supra* note 14, at 46-54.

106. H. ROSS, *supra* note 14, at 46-54, 203-04; Gifford, *supra* note 12, at 84.

107. Phillips & Hawkins, *supra* note 64, at 502.

108. See Kelner, *supra* note 70; Swofford, *supra* note 51, at 285; Fisher, *supra* note 48, at 23.

109. See Mowen, *Reducing Damage Awards Through Juror Marketing Research*, RISK MGMT., Feb. 1983, at 12; G. WILLIAMS, *supra* note 15, at 11.

110. Wall, Schiller & Ebert, *supra* note 100, at 87.

a client's attorney may place pressure on the client either to settle or proceed to trial because of the attorney's desire to avoid the difficulties and potential embarrassment of trial, the expense of prolonged litigation, the need for immediate funds, or, perhaps, the desire to build a reputation as a trial attorney.<sup>111</sup>

### 3. Motivations to Proceed to Trial

The event of trial has desirable consequences for clients in the same way that settlement has beneficial consequences. The most important of these is that, if a party's prediction proves correct, the outcome of trial will be more desirable than the last settlement offer. Obviously this can be so for only one of the parties, but a party with a propensity to risk may choose to gamble on the outcome of trial.

That a verdict is rendered determining the merits of the dispute is also of importance to many litigants. One side is declared a winner and the other a loser; one is right and the other wrong; one is vindicated and the other defeated. Many parties, both plaintiffs and defendants, perceive this as the greatest benefit of proceeding to trial and obtaining a verdict.<sup>112</sup> The reverse of this is equally true; settlement avoids a determination that one of the parties may find undesirable.<sup>113</sup>

Closely related to vindication are feelings of anger toward the opponent and a desire to inflict punishment. Trial is an expensive and emotionally debilitating experience for both sides, but often one side's anger towards the other is so great that a trial is forced in order to impose costs on the opponent, even though the other side will also incur costs.<sup>114</sup> In practice, it often is difficult to decide what part of a party's actions is based on a desire to vindicate principle and what part on anger, since the two go so closely hand in hand.

Perhaps the most surprising and interesting result of the survey was the importance of vindication and anger as factors influencing the decision to settle or proceed to trial. These purely noneconomic factors were listed as reasons for not settling in eight of the surveyed cases, almost as many times as risk was mentioned. For example, in a contract dispute where the amount at issue was relatively small, the plaintiff's attorney was quite candid in stating that his client refused to settle because she hated the defendant and wanted to punish him by forcing him through the experience of trial.

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111. See Lowenthal, *A General Theory of Negotiation Process, Strategy, and Behavior*, 31 U. KAN. L. REV. 69, 87, 109-12 (1982); H. ROSS, *supra* note 14, at 236.

112. See Rosenberg, *supra* note 105, at 816; Wall, Schiller & Ebert, *supra* note 100, at 86 n.8; Potter, *supra* note 72, at 528 (counseling against RICO claims against individuals because of the negative effect such claims have on the ability to settle).

113. See G. WILLIAMS, *supra* note 15, at 11; Eisenberg, *supra* note 36, at 659.

114. G. WILLIAMS, *supra* note 15, at 14 ("The intensity of emotion and ill-will generated by litigation is frequently overlooked, particularly as regards the opposing attorney."); Mnookin & Kornhauser, *supra* note 41, at 974.

In two of the three cases where anger was listed as a factor, it was not anger directed at a party, but at a party's attorney. In both cases, the claims adjusters, directly employed by the defendant in one case and by the defendant's insurance carrier in the other case, became angry with the plaintiffs' attorneys and forced trial as a method of punishment. In one of the same cases, the plaintiff's attorney also was angry at the claims adjuster and insisted on trial because of the small settlement offer. In all three of the anger cases, the estimated verdict was quite small, and that may have contributed to the willingness to act upon emotion. Even so, none of the surveyed attorneys involved in these cases seemed at all troubled by the attorneys' or claim adjusters' acting in ways that may have been contrary to their clients'/employers' interests or desires.

Vindication was even more important in causing cases to proceed to trial. In five of the twenty-two cases, vindication in some form was listed as a reason why settlement did not occur, although the circumstances varied widely. Justifications such as "pride", "vindication", and "conscience" were used, or just a statement that the client believed it was right and the other side wrong. What is interesting is that, for these parties, economics was not the deciding issue; decisions were made on the basis of honor and emotion. This is not to say that economics did not place a limitation on the exercise of these feelings. If more were at issue in these cases, it is more probable that settlement would have occurred. Presumably, a party is less likely to act on emotion when a large sum is at stake than when only a small amount is at risk.

Proceeding to trial also demonstrates commitment either to principle or to an entity. One principle frequently cited by insurance carriers is the desire to discourage nuisance suits,<sup>115</sup> although this reason was given only once by the surveyed attorneys. Of course, the consequence of this policy is also to impose on the defendant the same costs of trial. However, it is argued that the long-term savings realized through discouraging other nuisance claims will outweigh the short-term costs.

Commitment also can extend to clients.<sup>116</sup> For instance, a collection agency may be seeking to increase business by demonstrating its toughness and tenacity to creditors, or an insurance company may wish to show its insureds it will aggressively protect their interests. Commitment brings with it all of the negative consequences of proceeding to trial, but the positive effects are judged to outweigh any negative effects.

Commitment was given as one of the reasons for a failure to settle in five of the twenty-two cases. Business reputation and the effect settlement would have on this was the reason given in two of the cases, while the effect on other

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115. G. WILLIAMS, *supra* note 15, at 12. See Phillips & Hawkins, *supra* note 64, at 509-10; H. ROSS, *supra* note 14, at 204-11 ("[T]he rational company ought to aim at a reputation for not paying nuisance value while simultaneously utilizing nuisance payments to quiet claims that are not deterred by its reputation." *Id.* at 209). Of course, the economic rationale for paying nuisance claims is to avoid the greater expense of trial. *Id.*; Gifford, *supra* note 12, at 84.

116. Galanter, *supra* note 30, at 29. See generally H. ROSS, *supra* note 14, at 213-14.

potential litigants was given as the reason in the three remaining cases. Commitment can be explained as an economic decision, in that the immediate expense of trial is being incurred in exchange for expected long-term benefits in discouraging future litigation or harm to reputation.

An interesting example of a decision to exchange the short-term cost of trial for a hoped for long-term benefit occurred in a case resolved by directed verdict and therefore not reported in the survey. In that case, the insurance carrier for the defendant made the decision that the plaintiff's attorney was filing too many groundless claims. Generally, the carrier was willing to pay some amount in settlement of what it considered nuisance claims, but in this instance it decided to teach the plaintiff's attorney a lesson by refusing to settle and proceeding to trial. The insurance carrier's determination that the case was of nuisance value only proved correct as demonstrated by the directed verdict, but whether the experience had any deterrent effect on the plaintiff's attorney is not known.

A trial and verdict not only vindicate principle and demonstrate commitment but also can resolve issues of law in disputed areas, thereby providing precedents for future resolutions of similar questions.<sup>117</sup> A corollary is that an ambiguous state of the law may encourage settlement if the predicted resolution of the disputed question is unfavorable.<sup>118</sup> Similar considerations govern the collateral estoppel effects of any judgment.<sup>119</sup>

Finally, sometimes a case is so complex or unique that it is impossible for the lawyer to predict the trial outcome so that the lawyer or client can place any confidence in the prediction. No alternative exists against which to measure any settlement offer; the client is left to its propensity to gamble and to its own and the attorney's instincts in determining whether to settle or go to trial. The client may well choose trial.<sup>120</sup>

#### 4. Valuing Motivations to Try or Settle

The consequences of settlement and trial depend entirely on the particular party's situation. A consequence of one also serves as the opposite consequence of the other. If trial demonstrates a commitment to principle, settlement exhibits a lack of commitment, and so forth. Whether a consequence is beneficial or detrimental is a reflection of the party's needs and desires. The benefit of

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117. H. ROSS, *supra* note 14, at 166. The future predictive effect of a judgment may be of importance to the immediate parties to the litigation and also to others in either similar factual or legal situations. See generally Dan-Cohen, *supra* note 39. Thus, the frequency of filings by trade and industry groups. Bureaucratic organizations have an interest in judicially created rules as a basis for planning and ordering future transactions. Because organizations tend to be repeat players, they prefer clarity and certainty in the governing rules, even if the rule does not always work to the organization's benefit. *Id.* at 24.

118. G. WILLIAMS, EFFECTIVE NEGOTIATION AND SETTLEMENT 6 (Neb. CLE 1984); Galanter, *supra* note 90, at 100-03.

119. G. WILLIAMS, *supra* note 15, at 11.

120. Galanter, *supra* note 30, at 29; G. WILLIAMS, *supra* note 118, at 7-8.

settlement to one party, for instance, the avoidance of publicity, may be a detriment to another who desires publicity.

Each client's degree of risk aversion and assessment of the consequences of settlement and trial is unique. But rarely is a client's propensity or aversion to risk so high, or the value placed on the different consequences of settlement and trial so great, that some amount of monetary remuneration would not make the client indifferent between the choices of settlement and trial. Within some undefined limit, every consequence has a negative or positive price. The opponent who insists on vindicating principle will be willing to abandon that insistence in exchange for some amount of money. The client who wishes to avoid the emotional turmoil of litigation will agree to go to trial if the cost of settlement becomes too great. The question is what amount of money is necessary for a client to forgo a desirable consequence or to endure an unfavorable one.

Each consequence of settlement and trial can be monetized at a crude level by having the client determine the amount for which it would be willing to accept or forgo the consequence. If a defendant wants to go to trial to prove to the plaintiff that the defendant was not the wrongdoer in a breach of contract action, the value of the defendant's need for vindication can be established by asking what amount the defendant would be willing to pay to avoid trial. The defendant is not likely to be willing to pay the full amount of the claim and probably is willing to agree to pay nothing in exchange for a dismissal of the action. Somewhere in between these two extremes, the full amount of the claim and nothing, there may be an amount at which the defendant is willing to trade avoidance of trial for vindication.<sup>121</sup> This amount is the monetary value of the defendant's desire for vindication.

Parties rarely if ever base their preferences for trial or settlement on one consequence only. Instead, preferences in this area, as in nearly every other aspect of life, comprise a complex body of contradictory and complimentary likes and dislikes of varying degrees of importance. It is unlikely that a party will be able to value individually each of the consequences attendant to settlement and trial or even be able to differentiate in its own mind what all of the consequences are. Instead, as noted by a leading text on interviewing and counselling:

[I]t is often very difficult, if not impossible for clients to precisely quantify the value they place on specific consequences. . . . All that clients can usually do is give general statements of the value they place on the various consequences. Thus, clients can sometimes quantify consequences to the extent of labeling them as 'very important,' 'not so important,' etc. . . . What clients generally seem to do in making decisions is to try to take into account the positive and negative consequences of each alternative and then, through an intuitive weighing process, decide which alternative, on balance, seems best. In the course

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121. The amount necessary for the defendant to agree to forgo trial may be a negative amount, that is, the plaintiff pays the defendant some sum, as unlikely as this may be.



of this intuitive process, the client brings into play his/her own values and sense of appropriate risk avoidance.<sup>122</sup>

Clients, in short, tend to take a holistic approach to valuing consequences by weighing a proposed settlement offer against proceeding to trial. But even though individual consequences are difficult to value, each consequence does have a value and can be monetized and, in turn, the entire case can be valued. And though it is rarely profitable to value individual consequences, it is absolutely necessary to monetize the gross choices of settlement and trial, by adjusting the price of settlement against the anticipated outcome of trial, and making the client aware of all foreseeable consequences of each until the client is indifferent between the two choices. This sets the client's break-even point or the settlement value of the case.

The actual procedure of the client's determining at what point she is indifferent between settlement and trial is well described elsewhere.<sup>123</sup> For purposes of this discussion, suffice it to say that the lawyer should present the client with the results of Steps One, Two and Three. Once this information has been presented, the lawyer and client should jointly identify all of the favorable and unfavorable consequences of settlement and trial. Finally, the client must decide at what amount she is willing to settle the case in light of the information presented. This is the client's break-even point. If the case cannot be settled at this amount or better, the case should proceed to trial.

## 5. Timing

A client's break-even point is not necessarily static but may change through time. New facts come to light through further investigation, discovery, and the negotiation process, modifying the client's break-even point. More importantly, the client's relative preferences for settlement and trial may change as the weight accorded various consequences changes.<sup>124</sup> The client's preferences among consequences also may shift or the client's risk averseness may change, not from any external influence but because of the passage of time and further reflection. Preferences also may change because the client gathers additional information about the consequences and their potential effects.

In the early stages of litigation, clients usually have not given any great thought to their own objectives and preferences, but as the case progresses, these

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122. D. BINDER & S. PRICE, *LEGAL INTERVIEWING AND COUNSELING: A CLIENT-CENTERED APPROACH* 149 (1972). See generally P. GULLIVER, *DISPUTES AND NEGOTIATIONS: A CROSS-CULTURAL PERSPECTIVE* 88-96 (1979).

123. For excellent discussions of the counseling process for determining a client's break-even point, see D. BINDER & S. PRICE, *supra* note 122, D. BINDER, P. BERGMAN & S. PRICE, *LAWYERS AS COUNSELORS* 258-375 (1991), and Gifford, *The Synthesis of Legal Counseling and Negotiation Models: Preserving Client-Centered Advocacy in the Negotiation Context*, 34 *UCLA L. REV.* 811 (1987).

124. P. GULLIVER, *supra* note 122, at 89; Gifford, *supra* note 123, at 831; Lax & Sebenius, *The Power of Alternatives or the Limits to Negotiation*, 1 *NEGOTIATION J.* 163 (April 1985).

matters become more and more refined.<sup>125</sup> Early in the litigation, emotions usually are at a high point and a client's preferences are strongly influenced by anger, grief, remorse, etc. With time, emotions often subside, so that, for instance, a party whose highest priority at first was to punish the other side usually will feel less antagonistic as trial approaches. In the early stages of litigation, clients also generally do not fully realize the expense of litigation. They may know, on an intellectual level, that trial can cost, for instance, several thousand dollars more than settlement, but this truth has not penetrated to an affective level. Only time and the confrontation of reality, through paying attorney's bills, provide that realization.

Finally, many clients are unable in the abstract to monetize the choices of settlement and trial. They can make this decision only as part of making an offer or responding to a proposal from the other side. With no consequences attached, deciding between settlement and trial is a speculative exercise. The client who says go to trial at all costs may respond differently to a specific settlement sum.

Since clients' break-even points are inherently fluid, clients should make such decisions at the most opportune time. Certainly a client should be informed of the results of Steps One through Three at the earliest possible time in the representation, so that the client can incorporate the information and use it when approaching the many decisions necessary to litigation. Similarly, attorneys need to be aware of their clients' concerns and objectives as early as possible. Arriving at an actual break-even point or settlement value, however, should be deferred until it actually is necessary to make such a decision.

This is the point when the client is required to make or respond to an offer of settlement. Ideally this point should occur just before making a final offer or in responding to an opponent's final offer. At that time, many of the problems of changing goals and objectives, such as those stemming from anger at an opponent, can be avoided. Further, formulating or responding to a settlement offer forces the client to engage in the concrete decision-making that rules out abstract speculation.

As an illustration, in a personal injury case each side usually initiates the negotiating process by making extreme demands. After a series of offers and counter-offers, each presents its last offer. The last offer typically represents the lawyers' attempts to negotiate the best possible deal for their respective clients by asking for as much or offering as little as possible while still achieving agreement. Each side, in responding to an opponent's final offer, must decide whether its opponent is sincere in claiming this to be the last offer and must decide whether to accept the offer, make a counteroffer in hopes of the opponent reciprocating, or go to trial. If one makes a counteroffer and receives no response, only the two choices remain, to accept the offer or go to trial. If a response is elicited, negotiations proceed as before.

While a lawyer should keep his or her client informed about the progress of negotiations and the offers being made, only when the opponent gives a final offer

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125. Gifford, *supra* note 123, at 831.

must the client finally value its options. Only at this point must the client monetize the options of settlement and trial and decide whether the option of trial is worth more than the last offer.

Of course, the lawyer and client should have extensive discussions about the client's break-even point well before the final offer stage of negotiations. Clients need a realistic appraisal of the worth of their cases at the earliest possible stage of negotiations, to disabuse them of unrealistic expectations. But before negotiations begin, the client should decide on a "safe" break-even point; that is, a value sufficiently generous that the client will be content with it if, by chance, an offer is accepted immediately by the other side. If this occurs, there will be no chance to ask the client to determine a break-even point. Any offer made, including the final offer, should be at an amount acceptable to the client.

In addition, at least with smaller cases, often there is only one negotiating session, and at it agreement is reached or a decision is made to proceed to trial. There are no second or subsequent rounds. Therefore, the lawyer should know the client's break-even point before entering into negotiations.

It also is inefficient to continue bargaining and making concessions in a range that a lawyer knows the client will reject. Finally, many lawyers refuse to negotiate unless they receive assurances that their opponent has authority to settle. To avoid the risk of a refusal to negotiate, the lawyer should have authority to settle at least at a "safe" amount. But, if possible, a final break-even point should not be determined until a final offer is in hand.

Although errors can occur in Steps One, Two, and Three of the valuation process, it is theoretically impossible to commit error in Step Four, selecting a break-even point reflecting the client's preferences and values. Because the value a client attaches to the respective consequences of settlement and trial are unique to that client, no one but the client can say that the valuation of any consequence is incorrect.<sup>126</sup> The client, of course, may alter its valuation at any time and

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126. No one suggests that lawyers can accept settlement offers without authority or over clients' protests, but the practice literature often suggests it is the lawyer's role to urge upon the client the lawyer's judgment of whether a settlement offer should be accepted. See, e.g., Epstein, *Settlement: The Plaintiff's Perspective*, in CONTINUING LEGAL EDUCATION IN COLORADO, INC., COURTROOM PRACTICE 1-33, 1-40 (1985) (The single most common reason for cases going to trial is client refusal to accept a reasonable settlement."); Perritt, *supra* note 6, at 1251:

[N]egotiations between attorneys may produce a zone of agreement between the attorneys but not between their clients because the clients continue to have substantially different expectations about trial outcome. . . . The availability of an advisory verdict of some kind may be essential to close this client-to-client gap and thus permit the attorneys to settle the dispute on terms which the attorneys agree are reasonable.

*Id.*

One of the very experienced trial lawyers in the survey echoed this view, stating that he never asks what a client wants, but instead tells the client what amount should be taken. These views, of course, subordinate a client's preferences to the lawyer's.

If a client is fully informed of the attorney's best estimation of the verdict distribution and probability of liability, then the client's decision to settle or gamble on a better outcome at trial, being based on the client's aversion to risk, must be reasonable. Those who argue that the case should be settled at what the attorneys think reasonable are merely substituting the attorney's risk averseness for

for any reason, but at any given moment the client's correct break-even point must be the amount the client sets.

In conclusion, the final step in calculating a client's break-even point is to present the client with the results of Steps One, Two and Three and have the client, in light of this information, determine what amount will satisfy the client's economic, social, psychological and legal needs. This determination is based on the client's risk averseness as well as the client's perceptions of the beneficial and detrimental consequences of settlement and trial.

## VI. IMPROVEMENTS

Cases fail to settle for many reasons entirely unconnected to the valuation process. Even when a large bargaining range exists, with a number of possible settlement points that both parties find preferable to trial, the parties may fail to arrive at a settlement because of a breakdown in the bargaining process.<sup>127</sup> For example, the parties may fail to discover the existing bargaining range because of a refusal to make the concessions necessary to reveal the range. One side may hope to induce the other to make larger concessions; a side may seek to avoid appearing weak by making concessions; it may desire to save concessions for later stages of bargaining; or it may fear giving away too much without sufficient concessions from the other side.<sup>128</sup> Such bargaining breakdowns have little to do with the valuation process.

A failure to settle also may result when each side has correctly and accurately valued the case and the valuations do not yield any bargaining range on which the parties may arrive at an agreement. For instance, the parties both may correctly determine the verdict distribution for the case, but each have different degrees of risk averseness. The plaintiff may be willing to gamble on an outcome at trial toward the upper end of the verdict range while the defendant engages in the contrary gamble. If the verdict range is sufficiently broad and the transaction costs are low in relation to the anticipated verdict, each party then may find trial more attractive than any settlement figure agreeable to its opponent.

Errors in valuation may encourage or discourage settlement, depending on the direction of the error. If the error reduces the plaintiff's expectations of the amount or probability of recovery at trial, the result will extend the bargaining range beyond what an accurate valuation would yield. An error giving the defendant reduced expectations of the amount or probability of prevailing also will encourage settlement. Errors in the opposite direction reduce the bargaining range and make settlement more difficult or impossible.

Assuming that errors increasing and decreasing the bargaining range occur with equal magnitude and frequency, improving the accuracy of the valuation process probably will increase the settlement rate. The closer the parties are in

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that of the client.

127. See generally J. SHAPARD, *supra* note 9, at 46-49.

128. See H. ROSS, *supra* note 14, at 164-65; Mnookin & Kornhauser, *supra* note 41, at 975.  
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estimating the outcome of the trial and the damages to be awarded, if any, the more probably they will reach a settlement agreement reflecting the estimations.<sup>129</sup> When both parties agree about the outcome of trial, the desire to avoid transaction costs produces a bargaining range.<sup>130</sup>

Increasing settlement rates alone is not necessarily a desirable or beneficial outcome.<sup>131</sup> Settlement easily can be encouraged by a variety of means, such as increasing the costs of litigation imposed upon the parties.<sup>132</sup> But simply reducing the number of trials will not necessarily increase the efficiency of the system or make the outcomes of settlement more just than the outcomes of trial.<sup>133</sup> However, if methods can be devised to increase the accuracy of predictions about the outcome of trial, settlements can more accurately reflect trial outcomes while avoiding the costs of trial, both economic and otherwise. Such settlements should be encouraged.

### A. Reporting of Verdicts and Settlements

Each step of valuing a case contains opportunity for error, some remediable and others not, thereby affecting the accuracy of the final valuation. The discussion of Step One, determining the distribution of verdicts in similar type claims, showed that, if there was no verdict reporting service, individual lawyers encounter difficulties in collecting verdict information. For smaller cases, the relevant standard is often the amount for which similar type cases are settling.

There are several relatively simple remedies for these problems. First, as a requirement for entering a verdict, the prevailing party could be required to submit a factual summary of the case, including the facts concerning liability and a description of any damages suffered. For personal injury cases, it may be possible to develop forms with categories to be checked for the more common factual situations and injuries. This summary, along with the verdict amount, could be filed at a central repository kept by the state court administrator and indexed by type of case. A second relatively inexpensive approach is to have the state bar association or local bar associations in more populous jurisdictions assume the task of obtaining verdict information from the attorneys in each case resulting in trial. The information could be indexed and provided to lawyers in the jurisdiction.

More populous jurisdictions often already have a commercial reporting service publishing information about verdicts, but information about settlements

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129. See Landis, *An Economic Analysis of the Courts*, 14 J. LAW & ECON. 61, 101-02 (1971); Cooter, Marks & Mnookin, *supra* note 58, at 238; Brazil, *The Adversary Character of Civil Discovery: A Critique and Proposals for Change*, 31 VAND. L. REV. 1295, 1302 (1978); Perritt, *supra* note 6, at 1256.

130. See *supra* notes 8-9 and accompanying text.

131. See generally Galanter, *The Quality of Settlements*, 1988 J. DISP. RESOL. 55; Brunet, *Questioning the Quality of Alternative Dispute Resolution*, 62 TUL. L. REV. 1 (1987).

132. Galanter, *supra* note 90, at 121; Cooter, Marks & Mnookin, *supra* note 58, at 238.

133. See generally Galanter, *supra* note 131; Fiss, *Against Settlement*, 93 YALE L. REV. 1073 (1984).

usually is collected in a more haphazard way, often through the initiative of one of the parties involved. A solution to this deficiency would be to impose a reporting requirement for settlements similar to that proposed for verdicts. As a prerequisite to the voluntary dismissal of an action, the entry of a consent judgment, or the filing of a settlement agreement, the parties could be required to file a factual summary of the case, including settlement terms. The state court administrator, a bar association, or private reporting companies would collect and index the summaries.<sup>134</sup>

A statutorily or rule imposed system of reporting all settlements in pending cases will produce a more complete basis of precedent upon which the parties can rely in fashioning settlements in similar type cases. Provision can be made for parties with legitimate desires for confidentiality, such as preventing injury to reputation, but otherwise every settlement should be reported.<sup>135</sup>

Many settlements occur before any action is filed, and these settlements would not be reported under the proposed system. Enough cases are filed, however, that an ample record of settlements should be available for the guidance of interested attorneys. Defendants, particularly insurance carriers, may want to keep their settlement figures confidential, to avoid any precedential value the settlement might have, and therefore may want to reach an agreement with plaintiffs before any action is filed. To the extent this occurs, the system of reporting settlements will suffer. However, plaintiffs will quickly realize that the defendants' desire for confidentiality serves as source of bargaining leverage and will demand a premium to forgo filing suit and being subject to reporting the terms of any settlement. The higher price of settling before filing suit will serve to discourage presuit settlements for confidentiality purposes.

The systematic collection of verdicts and settlements is a relatively simple and inexpensive method of improving the accuracy of case valuations. The surveyed lawyers most frequently mentioned such a collection as needed to improve their ability to settle cases. Reporting the information would impose some hardship on attorneys, but the expected benefits are sufficiently great to justify the burden.

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134. Many judges during settlement discussions with the attorneys will inform them as to how similar cases have settled. Wall, Rude & Schiller, *Judicial Participation in Settlement*, 1984 Mo. J. DISP. RESOL. 25, 30, 35. The American Bar Association, *Report of the Action Commission to Improve the Tort Liability System*, Recommendation No. 3, 14-15 (1987), includes a recommendation that tort verdicts and settlements be collected and published, in part for use in settling cases. Bovbjerg, Sloan & Blumstein, *Valuing Life and Limb in Tort: Scheduling "Pain and Suffering,"* 83 NW. U.L. REV. 908, 960 (1989) makes a similar suggestion, but as a facet of a proposal for reforming the awarding of damages for pain and suffering.

135. See generally TEX. R. CIV. P. 76a and Annotation, *Public Access to Records and Proceedings of Civil Actions in Federal District Courts*, 96 A.L.R. Fed. 769 (1990) regarding the ability of attorneys to keep confidential filed settlement agreements.

### B. Outside Evaluations

The sources of error in Step Two are several. Predicting the law the trial court will apply and how the judge or jury will assess liability and damages requires speculation on the part of the valuing attorney, leading to inaccurate conclusions. Many of the alternative dispute resolution (ADR) devices discussed in the scholarly literature are methods of reducing speculation and increasing the accuracy of valuations by combining Steps One and Two of the valuation process. For example, such ADR methods as early neutral evaluation,<sup>136</sup> the mini trial,<sup>137</sup> and the summary jury trial<sup>138</sup> are designed to provide the parties with a prediction of the outcome at trial.<sup>139</sup> Providing the litigants with an assessment of a judge's or jury's reaction to a case may serve as the basis of settlement between the parties.

While even experienced attorneys can make errors in valuing a case, inexperienced lawyers have the most difficulty. Inexperience leads to unrealistic expectations and, in turn, to a failure to settle, or to delay in reaching an agreement.<sup>140</sup> One relatively inexpensive method of assisting such lawyers without imposing the administrative burdens and financial costs required by many of the ADR procedures is to create a panel of senior lawyers to provide assistance in valuing cases. With the sponsorship of the local court system or bar association, senior experienced trial counsel could be asked to make themselves available to examine cases brought to them by less experienced lawyers and to give an opinion in confidence about the anticipated outcome of the case. If necessary, the senior lawyer could be permitted to charge a minimal fee to help defray the expense of such assistance. While studies have shown that even experienced attorneys arrive at widely divergent values for the same case,<sup>141</sup> an experienced

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136. Early neutral evaluation requires a neutral figure to make an assessment of the facts and law in the case, based on presentations by the parties, and to make a prediction of the outcome of the case, but this prediction is not revealed to the parties at that time. The neutral evaluator then attempts to assist the parties in arriving at a settlement, but if these efforts fail, the neutral evaluator's prediction of the outcome of the case is revealed, along with the supporting reasoning. It is hoped that the prediction eventually will bring the parties together in settlement. See Brazil, Kahn, Newman & Gold, *Early Neutral Evaluation: An Experimental Effort to Expedite Dispute Resolution*, 69 JUDICATURE 279 (1986).

137. In the mini-trial, each side presents its best case, in a limited time period, to decision makers from the other side, usually along with a neutral figure. The decision maker for each side is then able to compare the relative strengths of each side's case. See S. GOLDBERG, E. GREEN & F. SANDER, *DISPUTE RESOLUTION* 271-79 (1985).

138. With the summary jury trial each side presents a summary of its evidence to an advisory jury that renders a verdict. See Lambros & Shunk, *The Summary Jury Trial: An Alternative Method of Resolving Disputes*, 69 JUDICATURE 286 (1986); Lambros, *The Summary Jury Trial*, 29 CLEV. ST. L. REV. 43 (1981).

139. See generally W. BRAZIL, *EFFECTIVE APPROACHES TO SETTLEMENT: A HANDBOOK FOR LAWYERS AND JUDGES* 15-82 (1988); Perritt, *supra* note 6, at 1259-1315.

140. Edwards, *Alternative Dispute Resolution: Panacea or Anathema?*, 99 HARV. L. REV. 668, 670 (1986); Aubert, *Courts and Conflict Resolution*, 11 J. CONFLICT RESOLUTION 40, 44 (1967).

141. See *supra* note 55 and accompanying text.

valuation should be of greater assistance than one arrived at by an inexperienced lawyer.<sup>142</sup>

## VII. CONCLUSION

In judging the adequacy of the schema for valuing cases which this discussion has presented, the question remains of whether the cost of applying it is worth the benefits. Answering the question requires posing several new questions.

The first is whether valuation is necessary. The argument is that the prospects of trial are usually so remote, particularly in urban areas with long delays between filing and trial, and the costs of litigation so high, that both sides see that cases will settle as a foregone conclusion. There is no need to value cases, because there is no realistic prospect of a case proceeding to trial.

Such an argument holds some truth. Certainly long delays in many jurisdictions exist between filing and trial, a problem exacerbated by the crowding out of civil cases by a seemingly ever expanding criminal docket.<sup>143</sup> But if in fact there is no prospect of trial, then we are dealing not only with a breakdown of our court system, but also with the more intriguing question of why any rational defendant would ever settle a case for less than zero payment. In reality, trial is not impossible, merely infrequent. Valuing the case is no less important when the prospects of trial are remote, but the time value of money will cause the plaintiff's break-even point to decline and the defendant's to increase.

A second question is whether the break-even figure arrived at is sufficiently accurate on which to rely. Here the argument runs that each case is so unique, and juries are so unpredictable, it is impossible to predict trial outcome. Again there is truth to the argument. Juries, even within the same jurisdiction, may differ widely in their assessment of liability and damages,<sup>144</sup> but jury behavior still remains predictable within some margin of error.

Although the distribution can yield only a range of verdicts, the correct question is, if not a break-even point, then what? Lawyers and clients still must decide whether to settle or try cases. If the decision is not to be made against a standard of expected jury behavior, then what standard shall we use?<sup>145</sup>

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142. Many judges will inform the attorneys of the judge's valuation of the case. Wall, Rude & Schiller, *supra* note 134, at 31.

143. Wermiel, *Drug Cases Crowd Out Civil Federal-Court Trials as Judge Calls Business Litigation a 'Stepchild'*, Wall St. J., Feb. 6, 1990, at A20, col. 1.

144. See generally Leebron, *supra* note 32, at 310; Bovbjerg, Sloan & Blumstein, *supra* note 134; M. PETERSON, *supra* note 31.

145. In supervising students in a clinical program as well as talking with members of the bar, it has been my experience that lawyers and students frequently return from achieving a settlement elated about the deal struck. When questioned about why they considered the agreement a good one, it became evident they had no standard against which to measure the agreement. They had not considered what would have been the outcome at trial nor had they used any other standard. The goal had been to reach a settlement, and having reached one and avoided trial, they were satisfied. See X.



Rational settlement requires consideration of the alternatives to settlement. Unless a client has decided on settlement at any cost, a decision in response to a settlement offer must be to accept it or to try the case.

Another question is whether the benefits of valuing a case justify the costs. Certainly the cost of acquiring information about verdicts in similar cases can be high if there is no available verdict reporting service. But even if the information must be acquired through the efforts of the individual lawyer, the cost should not be assigned solely to one case but amortized over all of the cases to be valued in the future with the acquired information. However, if the case is likely to be the only one of its type handled by a lawyer, then valuation may well not be cost-justified.

Only Step One of the schema entails substantial expense; the remaining steps can be accomplished in a relatively short period of time and with no out-of-pocket expenditures. Factual investigation and discovery presumably occur not only to value the case but also to prepare for settlement negotiations or trial. It would make little sense to carry these out solely for valuation purposes.

A final question is, does it make sense for experienced lawyers to use the schema when intuition and experience have worked well in the past? The answer, of course, is no. The schema is designed for lawyers without the abilities or experience to value cases. The schema forces these attorneys to consider and weigh consciously and systematically the information necessary to arrive at a case's settlement value.

Accurate valuation of cases is an essential tool for lawyers seeking just and fair settlements. While the potential for error is large, determining value is a necessary prerequisite to the rational settlement of a case.

## Appendix 1

### NEEDS FOR IMPROVING SETTLEMENTS

<b>Lawyer</b>	<b>Experience Level/Needs</b>
<b>1</b>	<b>Inexperienced</b> <ul style="list-style-type: none"> <li>a. Reporting of verdicts</li> <li>b. Method of evaluating strengths and weaknesses of cases</li> <li>c. Courses on settlement</li> </ul>
<b>2</b>	<b>Experienced</b> <ul style="list-style-type: none"> <li>a. Books and articles on valuation and courtroom psychology</li> <li>b. Ability to put self in shoes of jury</li> </ul>
<b>3</b>	<b>Experienced</b> <b>None</b>
<b>4</b>	<b>Experienced</b> <b>More experience</b>
<b>5</b>	<b>Medium Experienced</b> <ul style="list-style-type: none"> <li>a. Reporting of settlements</li> <li>b. Information on how lawyers put cases together</li> </ul>

**Lawyer**

**Experience Level/Needs**

6

**Experienced**

**Reporting of settlements**

7

**Medium Experienced**

a. **Reporting of verdicts**

b. **Reporting of settlements**

c. **Pretrial rulings on admissability of evidence and rulings on legal issues or ability to predict judges' trial rulings**

8

**Experienced**

**A more candid and realistic discussion of the facts by clients**

9

**Medium Experienced**

a. **Reporting of verdicts**

b. **Better understanding of the ways in which juries think**

10

**Inexperienced**

a. **Reporting of verdicts**

b. **Information about what influences juries in arriving at verdicts**

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**Lawyer****Experience Level/Needs**

11

**Experienced**

- a. Reporting of verdicts
- b. Reporting of settlements
- c. More experience

12

**Medium Experienced**

None

13

**Medium Experienced**

- a. Some formula or table that takes into account all of the many subjective factors and combination of factors going into the valuation of a case. Too subjective and complicated right now.

14

**Experienced**

None

15

**Medium Experienced**

- a. Reporting of verdicts
- b. Clients better informing their counsel of their settlement policies

16\*

**Experienced**

- a. Reporting of settlements
- b. Penalty on insurance companies for not settling until the last minute. Prejudgment interest.

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\* Lawyers 16 and 36 are associated and were jointly interviewed and gave joint responses.  
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**Lawyer**

**Experience Level/Needs**

17

**Experienced**

- a. More cases being tried so there would be a larger sample of cases
- b. More discussion with other lawyers about cases

18

**Medium Experienced**

- a. Courses on settling cases
- b. More time to sit down and do it right

19

**Inexperienced**

- a. More experience in evaluating and trying cases

20

**Medium Experienced**

- a. Training in case evaluation
- b. Information on what influences insurance companies in settling cases

21

**Experienced**

More experience

22

**Medium Experienced**

- a. Advice from experienced attorneys
- b. Availability of arbitration

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**VALUATING FOR SETTLEMENT**

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**Lawyer****Experience Level/Needs**

23

**Medium Experienced**

- a. Reporting of verdicts
- b. Reporting of settlements
- c. Information on how insurance companies evaluate and settle cases

24

**Experienced**

- a. More experience
- b. Information about how juries think and decide cases

25

**Medium Experienced**

- a. Courses on valuation
- b. More opportunities to talk with other attorneys about settlement
- c. Better cooperation and prompter responses from physicians

26

**Medium Experienced****Reporting of verdicts**

27

**Inexperienced****Reporting of verdicts**

28

**Inexperienced****Reporting of verdicts**

<b>Lawyer</b>	<b>Experience Level/Needs</b>
29	Medium Experienced More experience
30	Inexperienced More experience
31	Inexperienced a. Reporting of verdicts b. Reporting of settlements c. Advance information on jury panels
32	Medium Experienced Reporting of verdicts
33	Medium Experienced a. Settlement conferences where judge would give a valuation of the case b. Mandatory neutral valuation by a panel of lawyers c. Reporting of settlements
34	Medium Experienced An objective, systematic approach to valuation

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**VALUATING FOR SETTLEMENT**

55

**Lawyer****Experience Level/Needs**

35

**Experienced****None**

36\*\*

**Medium Experienced**

- a. **Reporting of settlements**
- b. **Penalties on insurance companies for not settling until the last minute.  
Prejudgment interest.**

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\*\* Lawyers 16 and 36 are associated and were jointly interviewed and gave joint responses.



## Appendix 2

### REASONS GIVEN FOR FAILURE TO SETTLE\*

#### Case 1

*Plaintiff:* Attorneys assessed liability differently.

*Defendant:* Attorneys assessed liability differently.

Client couldn't pay amount demanded by plaintiff.

#### Case 2

*Defendant:* Plaintiff wanted to vindicate deceased father.

Client's father wanted to show client was not at fault.

#### Case 3

*Plaintiff:* Disagreement over applicable legal rule.

*Defendant:* Attorneys assessed damages differently.

#### Case 4

*Plaintiff:* Client insisted on more damages than case was worth.

*Defendant:* Plaintiff's attorney miscalculated damages and wanted too much.

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\* The survey lawyers were assured that their responses would be reported in a way that would prevent the identification of the case being discussed. The wording and flavor of the lawyers' responses were preserved to the extent possible.

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Case 5

*Plaintiff:* High special damages would result in low net from offered settlement. Case on contingent fee basis.

*Defendant:* Plaintiff's attorney overestimated strength of case.

Plaintiff wanted vindication ("conscience case").

Case 6

*Plaintiff:* Plaintiff's attorney was angry at defendant.

*Defendant:* Personal conflict between adjuster and Plaintiff's attorney.

Client had low exposure and therefore willing to gamble.

Case 7

*Defendant:* Plaintiff's attorney angry at adjuster.

Case 8

*Plaintiff:* Client wanted to proceed on principal. Contingent fee case.

*Defendant:* Nuisance value case. Plaintiff wanted too much.

Client could not pay any judgment and did not expect to be liable.

Case 9

*Plaintiff:* Attorneys assessed liability and damages differently.

Client was willing to roll the dice.

*Defendant:* Plaintiff's attorney miscalculated liability.

Plaintiff wanted to recover money invested in experts.

Case 10

**Plaintiff:** Attorneys assessed damages differently based on different perceptions of the plaintiff's credibility.

**Defendant:** Plaintiff's attorney valued the case too high.

Case 11

**Plaintiff:** Defendant had reputation to protect and had already settled several similar cases.

**Defendant:** Client felt he had done nothing wrong and wanted to vindicate self.

Client did not want reputation of rolling over.

Client believed settlement would jeopardize later action over insurance coverage.

Client could not pay any settlement.

Case 12

**Plaintiff:** Defendant refused to make any offer.

**Defendant:** Defendant's attorney assessed case as no liability.

Case 13

**Plaintiff:** Client hated defendant and wanted punishment of trial.

**Defendant:** Client's pride.

Protect client's business reputation.

Client believed he was right and had done nothing wrong.

Client could not pay any settlement.

Plaintiff's attorney was misestimating liability and damages.

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**VALUATING FOR SETTLEMENT**

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**Case 14**

***Plaintiff:*** Attorneys assessed damages differently.

***Defendant:*** Client believed there was a reasonable probability of defense verdict and there was limited downside exposure if wrong.

Client needed to maintain credibility and show willingness to go to trial.

**Case 15**

***Plaintiff:*** Client needed money.

Client needed large verdict for vindication.

Defendant's attorney wanted to show that he could try cases.

***Defendant:*** Plaintiff was willing to gamble on a high verdict.

Client's insurance carrier was willing to gamble that it could do better by going to trial than Plaintiff's last demand.

**Case 16**

***Plaintiff:*** Defendant was incorrectly evaluating case and was unreasonable.

**Case 17**

***Plaintiff:*** Defendant was broke, pro se, and in prison.

Case 18

*Plaintiff:* Client was willing to gamble to get more.

*Defendant:* Plaintiff's attorney misestimated damages.

Plaintiff's expectations were too high.

Case 19

*Plaintiff:* Each side's attorney thought the other was liable.

Case 20

*Plaintiff:* Defendant's attorney believed no liability and wouldn't negotiate.

*Defendant:* Nuisance case. Insurance carrier will not pay on nuisance cases.

Case 21

*Plaintiff:* Dispute over question of law.

*Defendant:* Client worried about effect on other potential plaintiffs.

Attorney assessed at no liability.

Plaintiff's attorney wanted trial experience and was churning case.

Case 22

*Plaintiff:* Attorneys assessed liability differently.

Attorneys assessed effect of plaintiff on jury differently.

*Defendant:* Attorneys assessed damages differently.

Plaintiff's expectations were too high.

## Appendix 3

## TYPE AND OUTCOME OF CASES\*

1.	Personal Injury	Directed Verdict
2.	Contract	Plaintiff - \$6,200
3.	Personal Injury	Defendant
4.	Personal Injury	Directed Verdict
5.	Personal Injury	Defendant
6.	Personal Injury	Defendant Plaintiff on Counterclaim
7.	Personal Injury	Plaintiff - \$5,000
8.	Personal Injury	Directed Verdict
9.	Assault	Plaintiff - \$114,000
10.	Contract	Directed Verdict
11.	Landlord-Tenant	Plaintiff - \$416
12.	Personal Injury	Plaintiff - \$1,382.40
13.	Personal Injury	Plaintiff - \$350
14.	Personal Injury	Plaintiff - \$35,000
15.	Contract	Plaintiff - \$5,100
16.	Personal Injury	Plaintiff - \$50,114.60
17.	Misrepresentation	Plaintiff - \$8,458

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\* The cases in this table are presented in a different order than in the preceding table in order to assist in preventing the identification of the respondents in the survey.

62	<b>JOURNAL OF DISPUTE RESOLUTION</b>	<b>[Vol. 1991, No. 1</b>
18.	<b>Personal Injury</b>	<b>Plaintiff - \$8,768.29</b>
19.	<b>Contract</b>	<b>Settled</b>
20.	<b>Personal Injury</b>	<b>Plaintiff - \$5,205</b>
21.	<b>Conversion</b>	<b>Defendant</b>
22.	<b>Personal Injury</b>	<b>Defendant</b>
23.	<b>Personal Injury</b>	<b>Defendant</b>
24.	<b>Personal Injury</b>	<b>Defendant</b>
25.	<b>Personal Injury</b>	<b>Defendant</b>
26.	<b>Personal Injury</b>	<b>Directed Verdict</b>
27.	<b>Malpractice</b>	<b>JNOV</b>
28.	<b>Condemnation</b>	<b>Defendant</b>
29.	<b>Personal Injury</b>	<b>Defendant</b>
30.	<b>Contract</b>	<b>Defendant - \$2,500 on Counter-claim</b>