

Setting a Course to Mediation Success: Valuing The Risk Of Settlement

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Our previous articles have discussed how parties can use more rigorous financial, valuation and behavioral analysis to achieve mediation success.ⁱ This article reviews how Navigator can help parties value the risk of settlement.

The Risk Of Settlement

To determine whether a settlement proposal is worth pursuing, lawyers and their clients (the “Parties”) typically compare the proposal to the expected litigation outcome. The “standard model” for calculating the expected outcome is to multiply the estimated dollar amount recoverable on each claim by its probability of success, and then subtract the cost of litigation.ⁱⁱ Conventional wisdom dictates that the surplus created by avoiding litigation costs can be split by the Parties in settlement.ⁱⁱⁱ

However, many cases do not settle early when the litigation cost savings would be greatest; they settle later in the process when sunk litigation costs can no longer be avoided and there is less surplus to split.^{iv} Moreover, this standard model requires calculations of damage estimates and probabilities of success that are inherently subjective and uncertain and cannot be rigorously measured.^v

As a result, Parties considering settlement should address not just the uncertainty and risk of pursuing litigation. They should also consider the risk of a settlement.^{vi} This different perspective does not narrowly define the “cost” of resolution to include just litigation expenses and does not assume settlement costs are *de minimus*. Instead, Parties may determine that pursuing litigation “offers a cheaper cost of resolution than settlement” because the uncertainty of valuing a good settlement can be very high.^{vii} Under this different approach, settlement does not necessarily create certainty in place of litigation risk, and the true economic cost of a resolution is not limited to just the costs of litigation going forward.^{viii} Settlement should be understood to have its own risks that can make it a “speculative gamble.”^{ix}

In this different model, risk and uncertainty are normally considered highest at the beginning of litigation when the lack of information is greatest.^x As the weight of favorable and unfavorable evidence and case developments increases over time, the uncertainty and risk decreases.^{xi} Thus, the cost of litigation may not be a “surplus” that can be split in settlement if litigation is avoided. Instead, the cost of litigation may be a worthwhile investment to reduce uncertainty and risk of litigation and settlement, and to improve the Parties’ confidence in assessing the appropriate resolution.^{xii} The greater the uncertainty of outcome, the more the benefit of continuing litigation to reduce that uncertainty and increase confidence.^{xiii}

Moreover, since risk and uncertainty are the governing conditions in a lawsuit under this approach, the potential settlement value of a lawsuit is treated as having a random trajectory that reflects both the information that has been disclosed and the “variance of outcome” risk from information that has not yet been disclosed.^{xiv} The value of any litigation will rise or fall based on the stage of the case and the weight of evidence obtained or still unavailable.^{xv}

Using This Approach to Assess Risk of Settlement

The point of this different approach is not to ignore the standard economic model for calculating expected litigation outcomes when considering settlement. Rather, the point to keep in mind is that calculating the probability of success on claims, and estimating damages, should not be the end of the analysis.

Parties should instead understand that calculations regarding probability of success and damage estimates are subjective and uncertain and can vary significantly over the duration of the case depending on the significance of upcoming developments and expected disclosure of more evidence. High levels of variance make it hard to value settlements with certainty and confidence. Thus, Parties may decide in mediation, after conducting this analysis, that pursuing litigation is a favorable alternative: incurring more litigation costs can deliver a positive return if they increase the amount of information available to accurately measure risk in a litigation, and thus the value of a settlement.^{xvi}

Conclusion

Navigator can help Parties set a course to mediation success by identifying different ways to value their case for settlement, and how to respond to the other side's valuations. This analysis can in turn help Parties maximize their investment in any litigation when considering their settlement options.

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ⁱ [Setting-a-Course-for-Mediation-Success.pdf \(navmas.com\);](#)
<https://www.navmas.com/wp-content/uploads/2024/05/Navigator-Accounting-for-Risk-Aversion.pdf>; <https://www.navmas.com/wp-content/uploads/2024/05/Excessive-Optimism-In-Litigation-Outcomes.pdf>;
<https://www.navmas.com/wp-content/uploads/2024/06/Information-Asymmetry-in-Mediation.pdf>; [Navigator-Framing-and-Anchoring-in-Mediation.pdf \(navmas.com\)](#); https://cartiga-my.sharepoint.com/personal/jordan_wood_cartiga_com/Documents/Navigator%20Article%20%236%20--%20The%20Sunk%20Cost%20Fallacy.pdf.

ⁱⁱ See, e.g., J.J. Prescott and Kathryn E. Spier, *A Comprehensive Theory Of Civil Settlement*, 91 NYU Law Review 59, 69–70 (April 2016) (“Prescott and Spier Article”); John Bronsteen, *Some Thoughts About the Economics of Settlement*, 78 Fordham Law Review 1129, 1132 (2009) (“Bronstein Article”); Maya Steinitz, *How Much Is That Lawsuit In The Window? Pricing Legal Claims*, 66 Vanderbilt L. Rev. 1889, 1904–1905 (2019) (“Steinitz Article”); Robert J. Rhee, *A Price Theory of Legal Bargaining: An Inquiry into the Selection of Settlement and Litigation Under Uncertainty*, 56 Emory Law Journal 619, 620–621, 622, 629–630 (2006) (“Rhee Price Article”); Robert J. Rhee, *The Effect of Risk on Legal Valuation*, 78 I. Colo. L. Rev. 193 (2007) (“Rhee Risk Article”); Joseph Grundfest and Peter H. Huang, *The Unexpected Value of Litigation*, 58 Stanford Law Review 1267, 1272 (4/11/2006) (“Grundfest and Huang Article”), available

at <http://ssrn.com/abstract=899098>. <https://www.linkedin.com/pulse/mediation-tip-calculating-risk-adjusted-value-case-patrick-russell-pn3wc/> at 3 (illustrating the “product rule of probability”).

- iii *Rhee Price Article, supra*, at 620, 630–631, 632.
- iv *Rhee Price Article, supra*, at 622, 624.
- v *Rhee Price Article, supra*, at 620, 623, 624, 638, 678; *Steinitz Article, supra*, at 1909.
- vi *Rhee Price Article, supra*, at 623.
- vii *Rhee Price Article, supra*, at 624, 637, .
- viii *Rhee Price Article, supra*, at 620, 624, 637.
- ix *Rhee Price Article, supra*, at 624, 674, 689.
- x *Rhee Price Article, supra*, at 677.
- xi *Rhee Price Article, supra*, at 677.
- xii *Rhee Price Article, supra*, at 677, 678–679.
- xiii *Rhee Price Article, supra*, at 678–679.
- xiv *Rhee Risk Article, supra*, at 200; *Rhee Price Article, supra*, at 620, 637; *Steinitz Article, supra*, at 1909.
- xv *Rhee Risk Article, supra*, at 201.