

REALITY OF QUANTIFICATION FOR INTANGIBLES

The positive or negative value of the consequences of many decisions are neither anticipated nor quantified. Yet, experience in real legal disputes reminds us that the “intangibles”—the unquantified consequences not covered in a damages award—may prove the most consequential.

A recent research study that included interviews of corporate counsel found that corporate clients recognize litigation’s consequences as including costs of organizational distraction, internal time of valuable people pulled away from profitable work, costs of electronic data and discovery requirements, business relationships and reputation, in addition to the costs of lawyers and experts. As the researchers observed: “Corporate clients may view these concerns as extremely important, and worth factoring in, even if not easy.”¹ While their research focused on a corporate context, their observation rings more generally true: litigation or other legal entanglements often have more intangible but no less impactful consequences for the parties than legal fees and monetary awards.

It’s fair to say that there are two types of such intangibles: those easily monetized as direct costs or gains, and those not.

Direct Time as an Easy Monetizer

For all clients, and some lawyers too, litigation is fundamentally a distraction. It takes them from their businesses, their professions, and their normal non-litigation lives. Company lawyers speak of litigation as a “cost of doing business,” but it is also a cost taken from other business activities. The only difference between outside attorneys’ fees and expert costs, and internal company litigation-related costs is that the former are “out-of-pocket.” Yet, if the internal costs are real, it makes sense to calculate them as well, to the extent possible and feasible.

This is relatively easy to do for one aspect of executive and staff involvement in the litigation—their raw time. Lawyer and client can estimate the hours of management and staff time required for depositions, document discovery, witness preparation, and trial testimony and multiply by inputted hourly rates. Thus, if two lower level employees will have to spend 100 hours going through boxes of materials, and their salaries are approximately \$40,000 per year (\$20 per hour); the cost to the company would be \$2,000. Of course, if the IT department will be required to run massive electronic and data searches, their hourly rate will be much higher. A high level executive, salaried at \$360,000, costs the company

¹ Heavin, Heather and Keet, Michaela, “The Path of Lawyers: Enhancing Predictive Ability through Risk Assessment Methods,” *Canadian Institute for the Administration of Justice* (2016):19. Heavin and Keet note [at page 20] that without systemic methodologies which cover all relevant factors and put results in concrete terms, clients are arguably left to make decisions without the best available information.”

\$180 per hour. How much of that executive's time will be spent in depositions, witness preparation, and testimony?

When a lawyer-tree builder is considering the net costs and payoffs with a company client, it is worth discussing the professional and staff time demands that litigation will impose on the business.² Ask for approximate salaries; make some calculations. These would be subtracted from the net payoff on the corporate plaintiff's side and increase the net negative payoff number on the defense side.³

Sometimes, "bean counting" the person-hours is not worth the time spent on the exercise, as the total is not significant within calculated net payoffs. Even where the drain on personnel time might be significant, the client may be just as happy with a rough cut plug-in number (saving time in the discussion). Just ask: "What would it be worth to not have your staff working on or worried about this?" Or, "What's a guestimate of the cost of this distraction?"

Monetizing Financial Impact, Beyond the Hourly

For a corporate client, depending on the nature of the industry, the dispute, and its timing within their business cycle or product launch schedule, the consequences of litigation may be felt far beyond direct personnel time.

Sometimes, the tree-builder lawyer is advised to inquire more broadly, with questions such as:

- *If this litigation continues, and particularly if the other side were to prevail, do you have a sense of the budget increase your public relations department will seek to achieve damage control, or resurrection of public image?*
- *Is the company planning any initiatives, such as pursuing an acquisition or other new opportunities, or courting a suitor for its own acquisition, that would be impacted by this litigation? Is there a disclosure issue for a potential investor, in a securities filing, or in accountants' reports? How problematic or how costly would disclosure be?*
- *Would the impact be felt whether or not the company is successful in the litigation, or only in the event of a loss? Can the impact be quantified in dollars? How might it be repairable? Assuming nothing is certain and future predictions are inexact, can we consider a range? Is timing critical for estimating impact? Should we think more carefully about when discovery and depositions are likely to occur, when the trial date would be, and when to anticipate a verdict?*

² The astute reader may note that if the company would be paying many if not all of these salaries in any event, these should not be counted as litigation costs. That's true. However, the approach fails to consider the opportunity cost: how these employees' time would otherwise benefit the company. Their time multiplied by salary rates should be a minimum measure of this value. The true opportunity cost of diverting their time, attention, and energy could be much greater.

³ Arguments for considering the cost of time when applying decision analysis in a legal context are made by: Prestia, Paul, and Samaras, Harrie, "Beyond Decision Trees: Determining Aggregate Probabilities of Time, Cost, and Outcomes," *Alternatives to the High Cost of Litigation*, (2010). As readers would no doubt anticipate, I quarrel with their suggestion that conventional decision analysis requires "augmentation" to include it. Basic texts on decision analysis plainly state the requirement to consider time and its costs, including the time value of money. By way of example, see Clemens, Robert T. *Making Hard Decisions: An Introduction to Decision Analysis* (1996), on the topic.

On the individual plaintiff's side, particularly in any employment-related case, you might ask the impact of the litigation on the likelihood of the plaintiff finding a new job:

- *While the litigation is pending, what do you think the chances are of being hired within the next 6 months or a year? [Say 25%] What about after the litigation is ended? [Say 75%]*
- *So, assume that the litigation process will run for a year or 18 months beyond today, is it fair to say that the litigation itself may cost additional lost income? While that lost income would theoretically become part of back pay damages at trial, it will be additional loss if you are not successful. And perhaps more importantly, it tells us that an important consequence of the litigation is that it puts your career on hold, and that costs you in the long run.*

Individual or small business litigants might be asked to estimate the cost of lost consulting days or time off from work in a new job.

Here are some helpful catch-all questions:

- *Assume the discovery process would run through Y date, and the two-week trial will be Z months from now. Imagine that an always accurate crystal ball revealed that the company will not prevail in the litigation, and the damages awarded against the company will be \$X. How much more would it be worth to the company to avoid going through the process at all?*
- *Or, looking at it more optimistically, if the crystal ball determined that your side will prevail and will receive reasonable damages, how much less would you take in order not to go through the entire process? What would that be worth in dollar terms?*

At the risk of stating the obvious, when the litigation carries the risk of injunctive relief of any kind, honest efforts should be made to quantify the consequences of both favorable and unfavorable injunctive relief. For example:

- *What will it cost the company if it is ordered to cease or recall product sales?*
- *What will it cost to redesign packaging and advertise this redesign?*
- *What will it cost to liquidate a property or other commercial interest?*

For the defendant in an employment case:

- *What costs would the organization incur if the judge ordered the plaintiff's reinstatement? [Put differently: How much would the HR manager beg you to pay, after a reinstatement order, to settle and avoid reinstatement?]*
- *Would a key employee or top salesman opt to leave if the plaintiff were reinstated? How much would that cost the company?*

Obviously, when representing the former employee-defendant in a non-compete case, counsel should ask his client to estimate the costs of a potential injunction against competitive work within a certain time and geographic range.

Monetizing Linked Business Impact

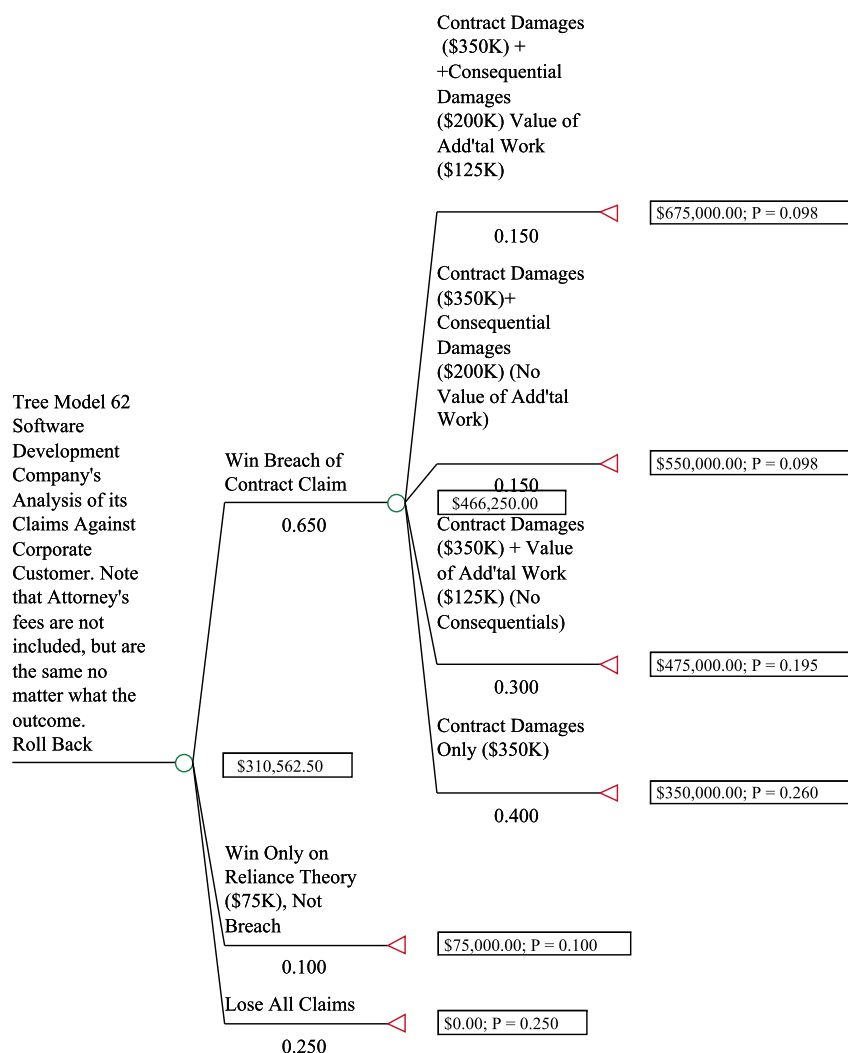
Consider a software development company that sues its large corporate customer for failure to pay for development services. Prior to filing suit, there was undoubtedly much wrangling over the scope of work, disputes about deliverables, and cross-accusations of failure to live up to contract terms. The software company's General Counsel might have analyzed litigation risks, assessing the likelihood of

prevailing on breach of contract and recovering the amount due, plus perhaps the claimed value of their additional work, or of prevailing only on a reliance claim but not breach of contract.

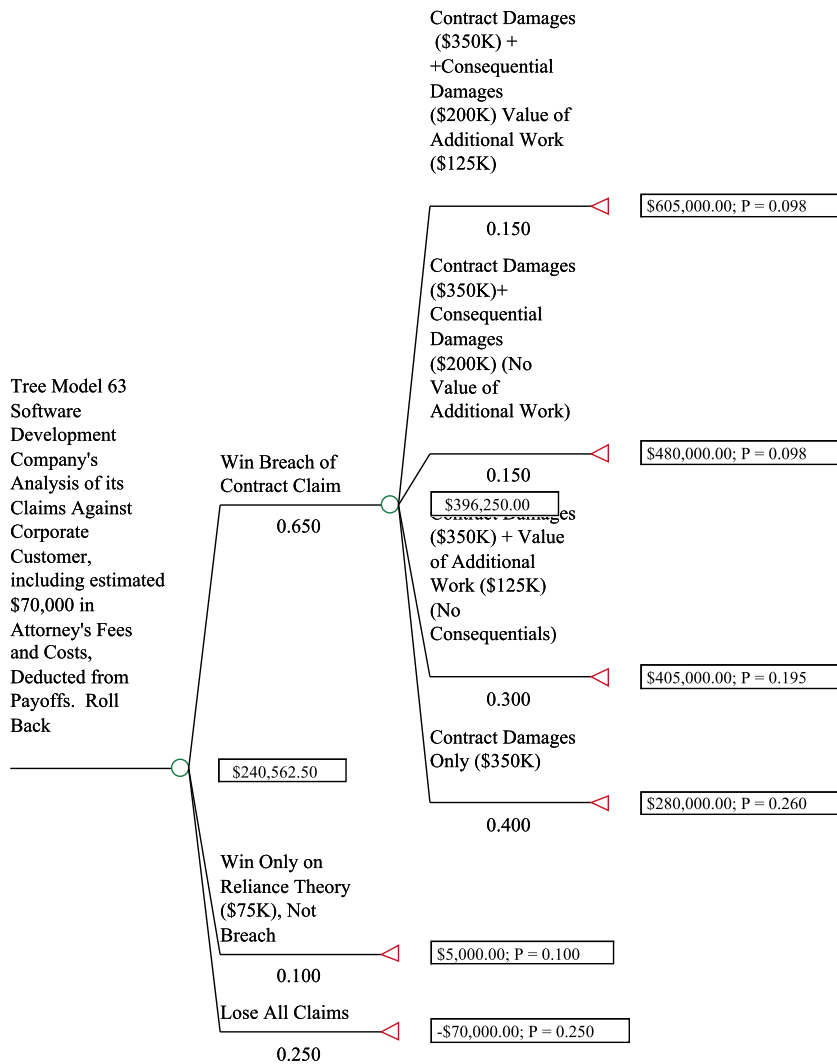
When the corporate customer counterclaims for breach, alleging deficiencies and delays in the software provided, the General Counsel will also create a decision tree for the counterclaim. In fact, a smart second-guesser could argue that the General Counsel should have considered the possibility of a counterclaim when constructing his initial tree.

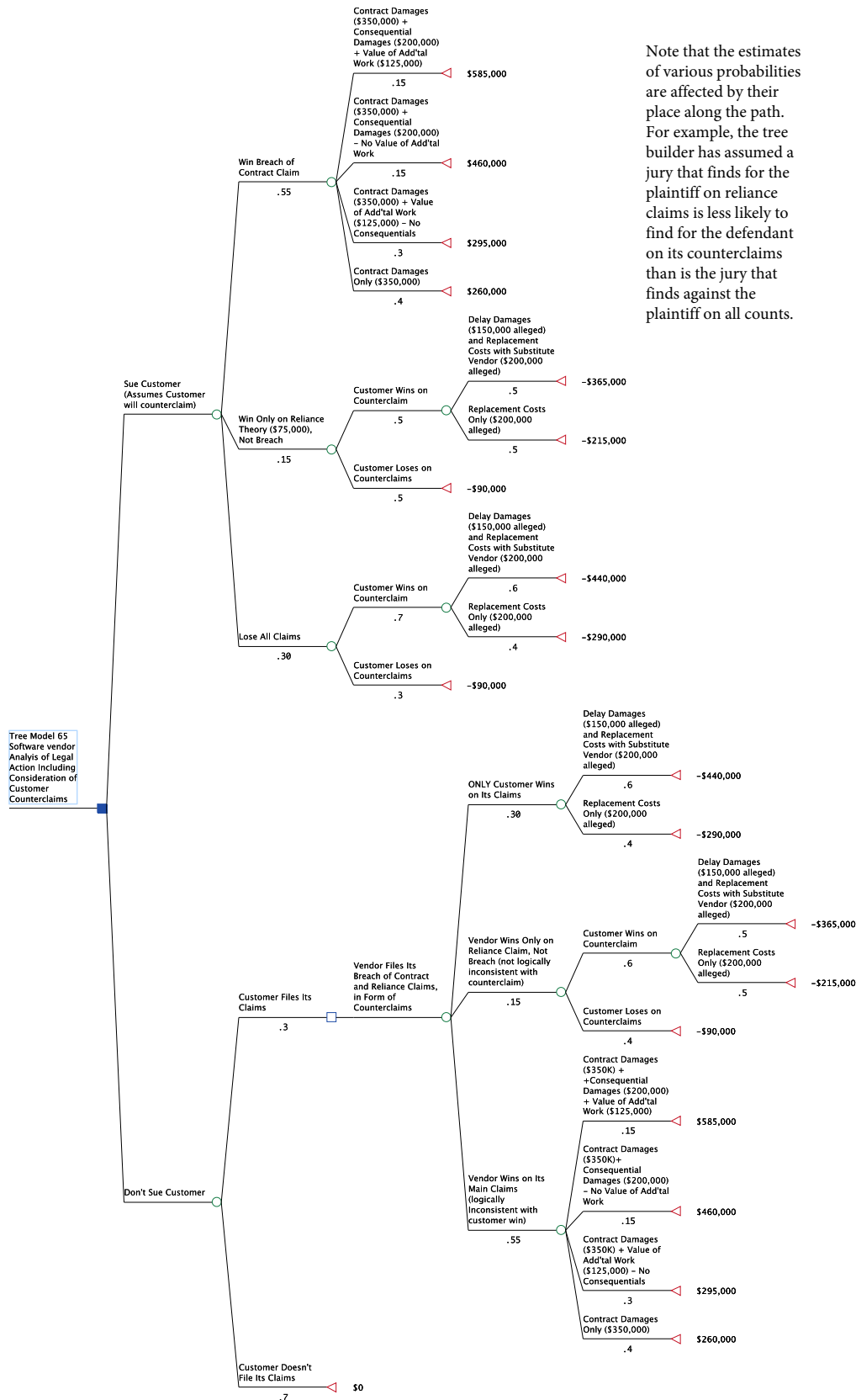
Simplified versions of these are set forth below.

The first Tree Model (62) reflects the main claims. Note that it does not include attorney's fees or costs that would reduce the net payoffs. However, it is fair to say that these fees and costs would be the same at the end of every branch path on the tree (at the terminal nodes).



Tree Model 63
Software
Development
Company's
Analysis of its
Claims Against
Corporate
Customer,
including estimated
\$70,000 in
Attorney's Fees
and Costs,
Deducted from
Payoffs. Roll
Back





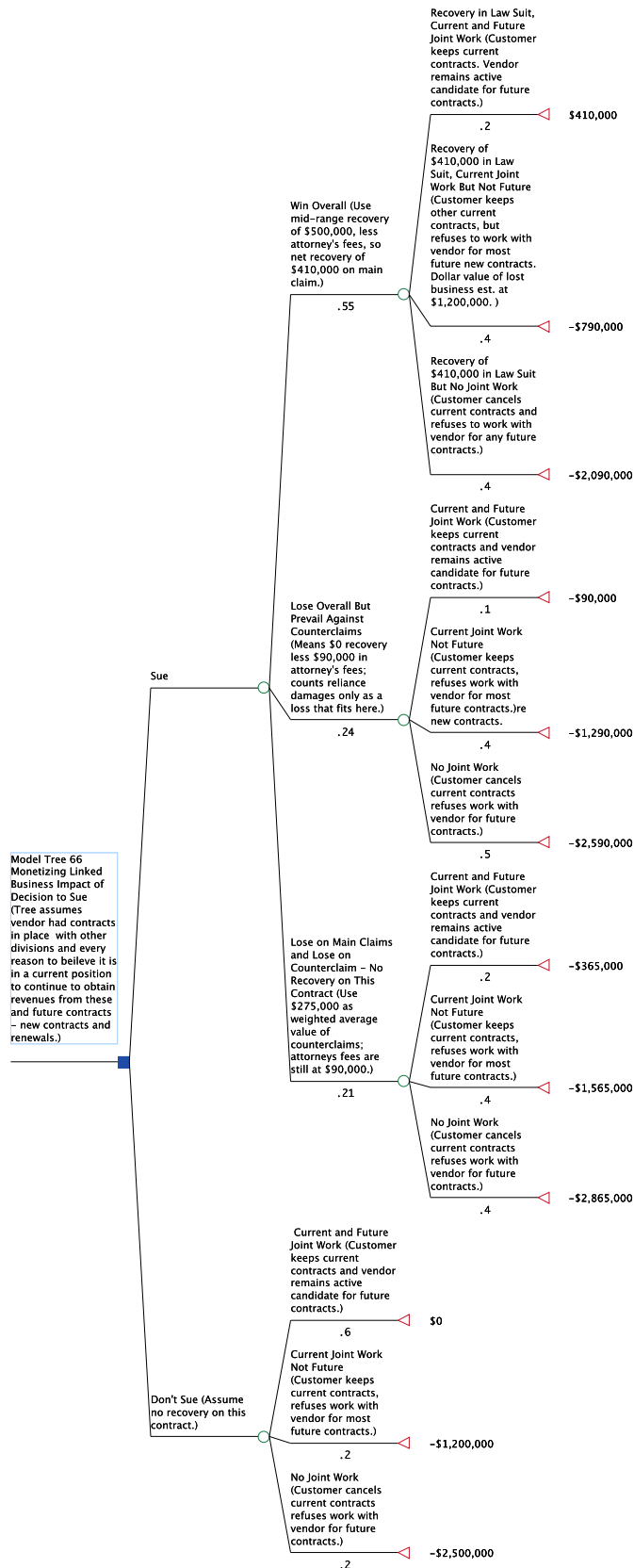
What's missing? We might note (as was true in the real case upon which this is based) that the General Counsel failed to consider any other contractual or business relationships between the parties. What if the corporate customer is a subdivision of a larger company? How many current or potential contracts for software services might be involved? What are the cancellation provisions in those contracts? What is the likelihood that this software company will retain the larger company's other business, or obtain new business? Might there be a larger impact within the industry?

Assume that the General Counsel is hard-nosed and brave, but not reckless. He is not scared off by a mere possibility that they might lose some business, with this customer or elsewhere. He will not run from the case if this is a vague, irrational, or exaggerated fear. Yet, wisdom tells us when certain fears are realized, the consequences are entirely real, and quantifiable.

Sage advice is to attempt to think carefully about and then attempt to quantify what that impact would be. The tree-builder would be wise to sit down with his client, do an inventory of current contracts and their termination provisions, and estimate the stream of new business and potential future contracts the other company may command. Without pretense to precision, an intangible damages subtree could easily be sketched, as reflected on the next tree.

When reviewing this tree, please note that it assumes major contracts, valued at \$2.5 million, which include a 60-day notice provision for termination. All of the contracts can be terminated without cause, with payment of any additional hours expended since the last contract payment. It assumes and includes an estimate of a cumulative \$1 million left in current contracts. It also assumes and includes maximum potential annual future flow of business from the parent company and all subdivisions of \$1.2 million. That's a total potential of \$6 million over five years. It might be fair to discount that by 50%, recognizing that they would not necessarily get all of this business, even without this dispute. The tree above thus includes a 50% chance of a loss of \$3 million in value as a result of filing suit.

It's worth remembering that if this decision tree were being constructed AFTER suit has been filed, the opportunity to win back future business might have been lost. Or, it would be much more difficult to retain this business than if the tree had been built before taking legal action.



Monetized Results Straight to Payoffs, or as Close as You Can Get

Why should tree builders focus on monetizing consequences? As discussed earlier, the answer is: “measurement bias.” The human psyche tends to “count” things that can be measured, and to undervalue that which cannot. Indeed, a primary purpose of decision analysis in litigation is precisely to ensure that consequences of chance and decision are counted, with appropriate discounts for their probabilities. To name payoffs and probabilities in numerical terms, rather than describing them as “big wins” or “less than likely,” is to measure them.

Life has a habit of yielding hybrids: outcomes partially stated in dollars, and partially not. One job offer includes a relatively high salary of \$X, with two weeks of vacation, two significant extra benefits, stable work structure and some opportunities for slow advancement. The other job opportunity has a lower salary, with four weeks of vacation, a few additional and attractive benefits, greater informality and opportunities for faster advancement. Research suggests that many will take job #1, and later become frustrated and dissatisfied. At the time of the decision, they seem to over-value terms that were easily measurable, and undervalue terms that were not.⁴

The same is often true for parties in litigation: the plaintiff may seek a high dollar settlement and reject a lower dollar offer that includes additional, clearly valuable terms where their value is unstated in dollars. They tend to measure the dollar number sought versus the dollar offered, and disregard or discount heavily the significance of other terms. In the settlement context, the simple antidote is to monetize—to estimate the dollar value of the additional terms, and include these within the calculations of the entire offer’s value.

Consider the hypothetical mediation of an employment dispute between a pharmaceutical company and its salesman. In the course of discussion, the plaintiff has stated his strong interest in pursuing a physician’s assistant degree, as well as keeping his company car and laptop computer. Which presentation of this identical offer is more likely to be accepted?

- a) \$150,000 payment plus out-placement services, tuition reimbursement for matriculation in a physician’s assistant degree program, keeping the company car and laptop computer,

Or

- b) Total value of \$225,000, which includes a \$150,000 cash payment, \$50,000 for tuition at the physician’s assistant degree program, the \$22,000 blue book value of the company car, and the \$3,000 price of the powerful laptop.

Most plaintiffs will be happier when the offer is presented as in (b) above. Not surprisingly, the opposite is true for the defendant company’s representatives. Fair dealing and fair questions would have required communication of these numbers to the company in the course of the negotiations. Nevertheless, when meeting with company representatives to seek the firm offer, a settlement proponent or mediator is advised to present it as in (a) above: “\$150,000 payment, plus tuition reimbursement, plus company car,

⁴ Hall, Brian and Staats, Trent, “Do the Numbers Get in Your Way?” *Negotiation* 7, no. 4 (2004).

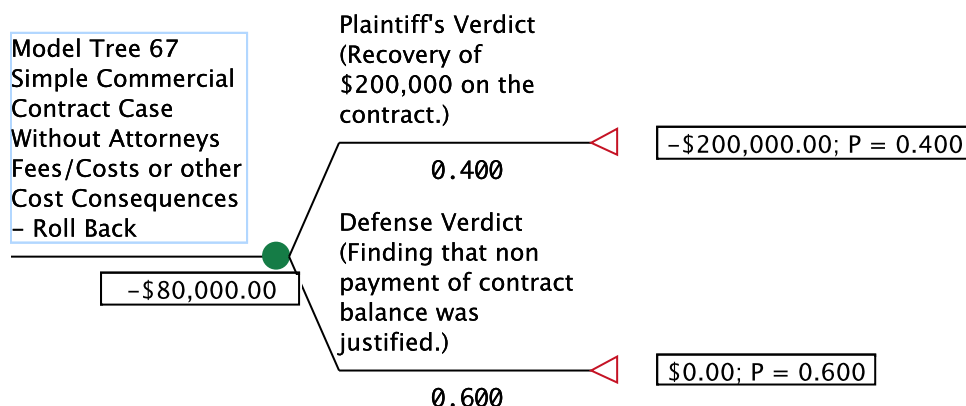
plus the computer.” Even though the company representatives should know the (at least approximate) total cost, a “yes” decision is more likely if its \$225,000 price tag is not highlighted.⁵

While I hope the reader recognizes the value of a decision analytic method for making wise decisions, it should be recognized that part of the method’s value is in forcing us to see what’s in the sausage. Particularly where decision trees are drawn, the branches, probabilities, payoffs-outcomes, and distribution of those pay-off-outcomes are clearly visible. The tree-builder, the lawyer, and the client can all visually follow the various paths.⁶ At the end nodes, they are confronted with imagining that how the case could play out in any and all of these ways—with the dollar amounts of liability and costs shown at the far right—as the payoffs at the end nodes.

Of course, for those receptive to the idea of using the EMV to inform decisions, the calculated roll back to the EMV is meaningful. If “non-monetary” but valuable or costly terms are excluded from the net-payoffs, they are obviously not in the EMV.

Imagine a decision tree built by the defendant company’s lawyer in a commercial contract case that does not include any fees or costs. Assume the simplest case, where the balance of the contract owed is \$200,000, and the question is whether the plaintiff fulfilled their end of the bargain or not, and thus whether the defendant was justified in withholding payment.

For the purposes of this example, and as reflected in the tree below, let’s also assume that the defense’s evidence against liability is pretty strong.

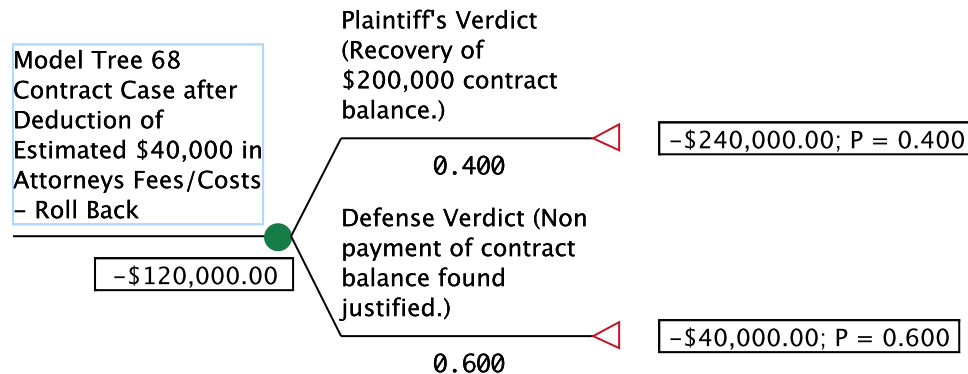


Next, imagine the same case, rolled back, after adding in estimated attorneys’ fees and costs of \$40,000. This is admittedly lower than in some recent examples. It assumes the case is legally straightforward.

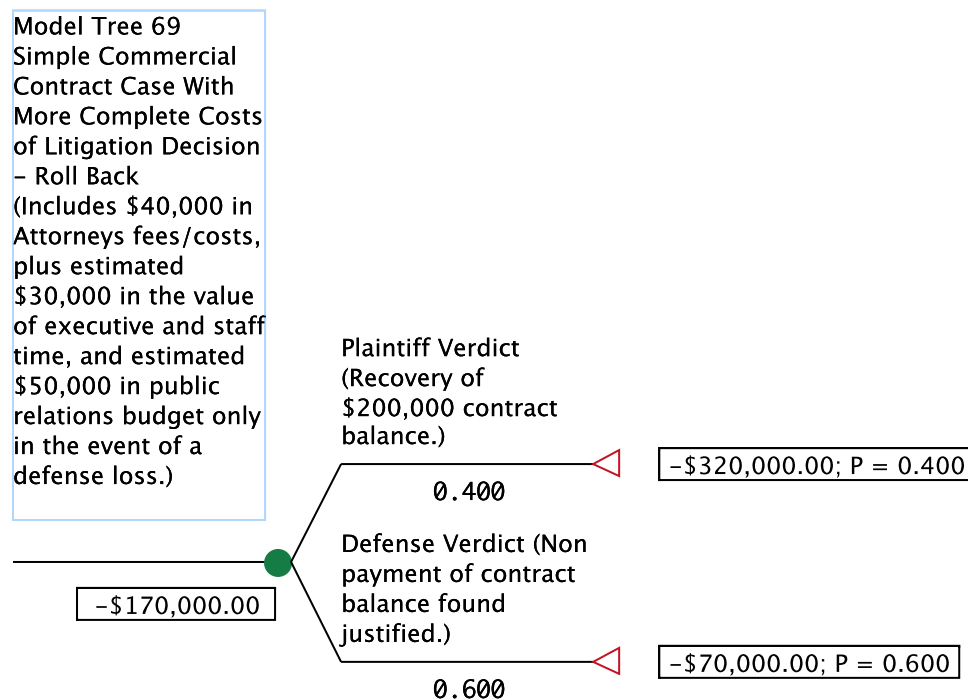
⁵ Tversky, Amos and Kahneman, Daniel, “The Framing of Decisions and the Psychology of Choice,” *Science*, 211, no. 30 (1981). For additional and accessible explanations of Prospect Theory, risk aversion and loss aversion, see Plous, Scott, *The Psychology of Judgment and Decision Making* (1993); Kahneman, Daniel and Tversky, Amos, “Prospect Theory: An Analysis of Decision under Risk,” *Econometrica* 47, no. 2 (1979): 263-91. The fact that the risk loss will take place in the future undoubtedly causes it to be discounted as well. See Frederick, Shane; Loewenstein, George; and O’Donoghue, Ted, “Time Discounting and Time Preference: A Critical Review,” *Journal of Economic Literature* 40, no. 2 (2002): 351-401. For experimental research demonstrating the application of prospect theory in legal settlement contexts, see Guthrie, Chris “Framing Frivolous Litigation: A Psychological Theory,” *The University of Chicago Law Review* (2000).

⁶ While a spreadsheet approach to the calculation will yield the same numerical results, that visual presentation seems less powerful to me. For those accustomed to and persuaded by the power of spreadsheets, my preference need not apply.

Still, there would be discovery and many corporate witnesses to defend on deposition and prepare for trial.



Next, here's the same case, but after including costs of executive and staff time estimated at \$30,000. (This is based on ten executives with time valued at \$1,000 per day, for two days each, plus at least twenty days of staff time in complying with discovery). The tree also reflects a consequential increase of \$50,000 to the public relations budget.



Can't We Just Talk About it?

Why not just create the tree and calculate the net pay-off with only experts' and attorneys' fees, yielding an EMV of \$120,000, and then add, orally or by written notation on the tree: "plus ten days of executive time and twenty days of staff time, plus a \$50,000 increase to the PR budget?" As stated earlier, the post

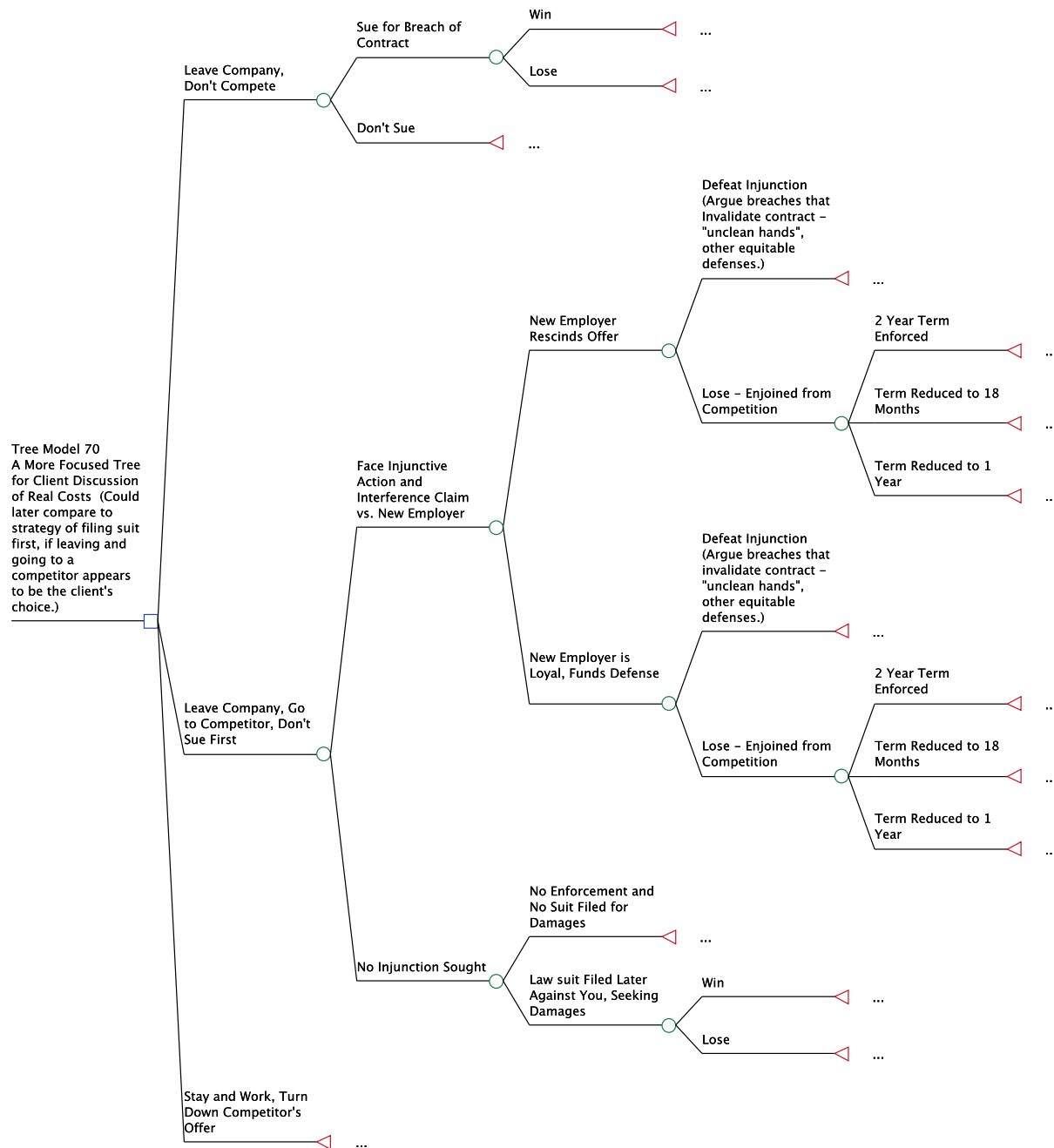
roll back EMV and the end pay-off numbers are what stick in our minds. Thus, if these fail to include real financial consequences, their impact on the decision may not be commensurate to their reality.

While firm about the truth of this assertion—that including financial consequences should be included in payoffs and this calculation—I hereby offer a back-up plan. If it's not feasible to estimate and include these financial consequences in the payoffs, DO at least *write* them on the tree document. At the risk of micromanaging, I suggest placing them on the tree as near to the end node/payoff notations as possible. And, with an arrow pointing to the EMV, clearly note that the EMV does not take into account the following financial consequences. Of course, references to these financial consequences should include their numerical value. It's less compelling to write: "This EMV does not include executive and staff time, public relations, or opportunity costs," than to write: "This EMV does not include \$30,000 in executive and staff time, \$50,000 in expenses related to public relations: total of \$80,000, without other opportunity costs."

As discussed earlier, estimating consequential costs can be reasonably straightforward when it involves multiplying estimated executive and staff time by the salary value of that time. Other categories of costs will be just as real when incurred but require deeper and wider inquiry to be fairly estimated. The tree-builder lawyer's purpose is not dire warnings of exaggerated cost numbers, but rather to elicit understanding of the actual projected impact on business or professional expenses and revenues. The exercise is an attempt to solidify and monetize what might happen, in honest, real ways. After all, the \$50,000 required for remedial public relations is just as real a business expense as the \$20,000 spent on fees, costs, or damages award.

Monetizing consequences would be just as important, arguably moreso, for the client salesman, unhappy at his treatment by his employer but subject to a non-compete agreement. Imagine that this client recently received an offer from a competitor and came to a lawyer for advice. He may have some good defenses against the non-compete: claims for breach of contract due to deliberate management actions and broken promises on compensation. Theoretically, he could assert these claims independently. He has a number of different choices, each with potential consequence. For example: he could leave the current job but elect not to compete for the requisite period; or he could leave and go to the competitor company (which may or may not take up his defense.) If so, his current employer could file for injunctive relief and the competitor company may or may not take up his defense or rescind the offer. He could also turn down the offer and stay at the current job. Under various scenarios, he could assert his breach of contract claims.

It's a complicated decision. The dollar reductions in family income will be felt just as severely as litigation costs if that former salesman is enjoined from competing in the territory and is unable to find work, or works and rents an apartment outside the territory. In my view, the plausible decision tree shown below, demonstrates the obvious benefit of drawing and discussing it with the client. And, looking to the terminal nodes, it's easy to see the value of estimating and recording predictable financial costs and gains with each of the client's choices.



The perfect need not be the enemy of the good. Even if a perfect estimate of financial consequences is not possible, a good faith effort at a reasonable estimate is good enough, and better than excluding that cost entirely from the net outcomes.