Alternatives

TO THE HIGH COST OF LITIGATION

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Settlement

The Computer Heist: How an Unusual Mediation Recovered from Its Rocky Beginnings

BY DAVID A. HOFFMAN

In commercial mediations, the path to settlement is often a winding road, replete with switchbacks, hairpin turns, and giant potholes. Navigating such a path requires flexibility on the part of the mediator, counsel and the parties.

Many of the obstacles in such a journey are emotional, and this can be true even in those business cases where the legal and factual issues are dry as dust. And in some cases, the emotional intensity arises not from the underlying dispute but instead from the secondary conflict that arises because of grievances about the other side's bargaining behavior.

A recent mediation exhibited all of these obstacles and then some.

The case involved an insurance claim filed by a manufacturer seeking $31 million from its insurer because of the theft of computers from the company's warehouse. (Note: Certain identifying information has been changed in this case study to protect the confidentiality of the mediation.)

The computers—several thousand of them—were stolen by a small group of employees, who sold them to used computer dealers. When the thefts were discovered, the manufacturer fired the employees, reported the thefts to the police, and filed a claim with its insurer. The stolen computers were never recovered, having been sold on the "gray market."

The insurance company refused to pay the manufacturer's claim, asserting that the units were outmoded—they were no longer being marketed by the manufacturer and, in fact, were slated for destruction. The manufacturer agreed that the units were going to be destroyed, but pointed to language in the policy which protected it from "losses" arising from theft. The manufacturer claimed, with support from expert witnesses, that the demand for its products was dampened by the flood of recent models available in the gray market at bargain-basement prices.

The parties attempted to negotiate a resolution of this dispute on their own and without a mediator or outside counsel. Both sides believed that once outside counsel became involved, positions would harden and vast sums would be spent on litigation. The insurer responded to the manufacturer's $31 million claim with an offer of $350,000, arguing (a) that the term "losses" does not encompass the market effect created by stolen goods, but that (b) the "nuisance value" of the claim (i.e., the cost of defending the claim in court) justified a $350,000 offer.

DISCOUNTED CLAIM

Although the manufacturer's management

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tended to and revised based on the changing circumstances of the case.

The opposing party may uncover a document putting the case in a whole new light, may fail to raise its best legal arguments that you identified, obviating the need to research those legal issues, or a key witness may quit the company and refuse to cooperate further. The list of possibilities is endless, and all must be handled as they arise.

But the initial case plan puts both corporate counsel and outside counsel on the right course to an efficient and effective outcome, and becomes an invaluable document with which to manage the case moving forward. It is shared and discussed with corporate counsel as well as with all members of the outside legal team, so that everyone is on the same page regarding the client's goals and strategy.

The factual and legal sections of the initial case plan form the basis from which to draft a mediation brief, and as they are fleshed out with further research, documents, and witness testimony, take shape into the major pleadings in the case.

Even more important, however, the initial case plan is a cornerstone for effective communication and collaboration between corporate and outside counsel, in laying down a plan to help the client achieve its goals as quickly and economically as possible.

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team found the insurer's offer insulting, the company was in dire straits financially—literally on the brink of bankruptcy—and needed cash. So, the company responded with an offer to settle the entire claim for $5 million.

This amount, it argued, was a bargain for the insurer because the wholesale value of the stolen equipment, even after deducting sales commissions, amounted to $31 million, and the manufacturer's expert would testify that the weakened demand for the company's newer computers would cost the manufacturer at least that much.

The insurance company responded with a $1 million offer, and argued that this was generous in view of the weakness of the manufacturer's legal theory and the speculative nature of the damages. The insurer cited its own expert's report, which contended that the market effect of the thefts could not be accurately predicted or modeled because (a) the product was so new that there were no stable benchmarks from which to measure demand, and (b) the entry of multiple new manufacturers of computers each year, with a wide variety of features and functions, made it difficult to measure the effect of increased supply of any one type of computer.

The manufacturer did not respond to the insurer's offer, and negotiations stalled.

One year after the theft and the initial negotiations, the manufacturer filed suit against the insurer, and both sides "lawyered up." Outside counsel for the two companies explored the idea of mediation.

Both sides were skeptical about whether there was any chance that a mediator could bring the parties together because the gap was so large. They recognized, however, that the investment in mediation would be small in comparison to the potential savings. This author was hired to mediate the dispute, and we scheduled an initial session.

Prior to the mediation session, counsel for each side submitted to me (and exchanged with each other) voluminous, well-argued briefs, citing cases that interpreted language similar to the language of the manufacturer's insurance policy.

Each side believed that the cases it cited were dispositive. The reality, however, was that there were no cases directly on point because the language in insurance contracts differs widely.

The mediation session—attended by in-house counsel, outside counsel, and several representatives from each company—began with opening statements from outside counsel. Each expressed astonishment at the other side's intransigence in the face of what each saw as an overwhelmingly persuasive case. The parties suggested that I meet with each side separately to determine how much flexibility each side had regarding their settlement positions.

SHUTTLE DIPLOMACY

I began with the manufacturer, to see whether it would provide a counteroffer to the insurer's $1 million offer. The manufacturer's representatives and counsel told me that the company's cash position had improved significantly during the past year, and it no longer needed a quick settlement. Because it was prepared to go the distance with its claim, and the company's management was angered by the insurance company's apparent effort the year before to take advantage of the company's economic distress, the company's new proposal for settlement was $10 million.

I tried to persuade the company to make an offer that was lower than its previous $5 million proposal because any proposal higher than that amount would likely end the mediation. After a two-hour meeting with the manufacturer's representatives, however, the lowest figure that they would authorize me to communicate was $6 million.

Anyone experienced with business negotiations could have predicted the insurer's reaction to this $6 million settlement proposal—namely, that they would hit the roof, and they did.

"What the #@!*% are they thinking?" the insurer's counsel shouted. "Does this mean that we should drop our $1 million proposal to $250,000?!?"

That meeting also lasted for two hours. The insurer's representatives were outraged, criticized me for wasting their time, and excoriated the manufacturer's representatives for duping them into coming to a mediation with no intention to bargain in good faith.

"Give me one good reason to continue with this process," the insurer's counsel said.

I explained that the manufacturer's financial situation had changed, and it no longer had a desperate need for cash. In addition, a year had passed, and in Massachusetts the annual rate of pre-judgment interest is 12%, which substantially increased the potential value of the manufacturer's claim. After much moaning and groaning about the manufacturer's bad faith, the insurer proposed $1.5 million as a settlement.

I then asked both sides if there was any possibility of a continuing business relationship. The answer on both sides was an emphatic "no." Thus, the bargaining in this mediation was likely to be essentially distributive—i.e., negotiating a number and no other terms. The only potential for joint gains was the reduction of litigation costs if the case settled.

PROGRESS AND IMPASSE

After several rounds of back-and-forth bargaining, although there was progress on the amount, the parties found that they were at an impasse, with the manufacturer demanding $4.6 million and the insurer offering $2.75 million. See the chart below.

Both parties thought that case evaluation would be useful. My recommendation was that they use someone other than me as the case evaluator, because my evaluation might impair my usefulness as a mediator. But, given the voluminous briefs and highly technical issues involving economic modeling and insurance contract interpretation, the parties and counsel concluded that educating an additional neutral would be too expensive and time-consuming. They were willing to take the risk that my case evaluation would alienate one side or the other and tank the mediation.

So, I created a set of risk-analysis charts, illustrating the various uncertainties in the case and the risk-discounted value of the claims. I then added to those figures the statutory pre-judgment interest, and predicted a risk-discounted value of the manufacturer's claims of $4 million.

In response to the case evaluation, the manufacturer dropped its demand to $4.48 million, and the insurer raised its offer to $4 million, but added to the settlement terms the release of another claim by the manufacturer from a different case. The manufacturer responded by offering to settle for $4.5 million and a release of all claims. Each side described its new proposal as last-and-final. Once again we were at an impasse.

The Offers, In Sequence

Plaintiff	Defendant
$31 million	$350,000
$5 million	$1 million
Mediation begins	
$6 million	$1.5 million
$4.85 million	$2.5 million
$4.6 million	$2.75 million
Impasse	

A MEDIATOR'S PROPOSAL

With the parties separated by only $500,000, I suggested the possibility of a mediator's proposal. I explained the ground rules as follows: I would make the same settlement proposal to each side and then, after the parties had considered it, I would talk with each side separately on a confidential basis to find out if they would be willing to settle on the terms that I proposed.

I promised confidentiality with respect to the answer. I told the parties that I would either report no settlement—because one side or both sides declined to accept the mediator's proposal—or that there was a settlement because both parties had said "yes." The idea behind the mediator's proposal, as a process option, is that each side has an opportunity to say "yes" without letting the other side know that the answer is "yes," unless both sides agree.

I made an unsurprising settlement proposal of $4.25 million with a mutual release of all claims. On a confidential basis, the manufacturer agreed to that figure, but the insurer did not. I reported to the parties that there was no settlement.

"If you think it would be helpful," the manufacturer's representatives privately told me, "let them know that we accepted your proposal and would be willing to split the difference and settle at $4.125 million." I suggested that this might not be wise, and that a smaller move—to $4.375 million—might allow them to "test the waters," so to speak, and see whether the insurer still had some flexibility.

The manufacturer accepted this advice, and the insurer responded with a $4.125 million offer that the manufacturer accepted, settling the case.

LEARNING POINTS

This case was unusual in several respects.

First, I have rarely seen cases where the mediation continued after Party A made an offer that was materially worse for Party B than Party A's previous offer.

The manufacturer did that in this case, raising its demand to $6 million, from $5 million, in the first round of bargaining. The insurer continued with the negotiation, after two hours of exhortation from their mediator, because I was able to give them a face-saving cover—namely, the one-year hiatus in the negotiations, the impact of pre-judgment interest, and the fact that the manufacturer's financial crisis had passed.

One of the learning points here was that even when one side or the other violates the norms of distributive bargaining—e.g., the unwritten rule that each proposal should be a step toward the middle, rather than in the opposite direction—all hope of settlement is not always lost.

Second, I learned that even the driest business cases—and could anything be drier than an insurance coverage dispute?—can generate a lot of emotion.

In my two-hour caucus session with the insurer, after the manufacturer raised its demand to $6 million, the insurer's representatives were hurling the saltiest invectives about the manufacturer's motives and integrity, and accusing me of naiveté and worse.

Venting, of course, is an essential ingredient in some mediations.

Third, although some mediators avoid such explicitly evaluative techniques as a mediator's proposal or a formal case evaluation—the parties in commercial cases often want such input and see these techniques as a sensible way to avoid the cost of educating a case evaluator.

Of course, many mediators believe that such techniques are inconsistent with true mediation, which they would describe as purely facilitative. I learned that it is possible, even after providing explicitly evaluative input, to facilitate the parties' negotiations. Doing so was made easier in this case because the parties were highly sophisticated and thus were only somewhat influenced by my opinions about the value of the case.

Finally, I learned that even highly sophisticated parties sometimes need negotiation coaching from the mediator.

In the final negotiation stages, the manufacturer was too ready, in my opinion, to put a

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near-final number on the table. To be sure, there are risks in giving such advice—it can back-fire. But mediators often help choreograph the bargaining dance that leads to settlement.

When we are using caucus sessions, we have information that the parties lack regarding each side's flexibility or lack of it. In this case, the advice worked. My suggestion that the manufacturer proceed somewhat more slowly—moving to $4.375 million from $4.5 million, instead of moving more aggressively—was effective: It elicited an offer from the insurer that settled the case.

The bottom line is that mediation requires creativity at times, regarding process as well as outcome. Mediators often play different roles at different stages of a case. At the same time, it is vital that the mediator and the parties and counsel agree, as they did in this case, on every important aspect of the process, or the mediation is likely to fail.

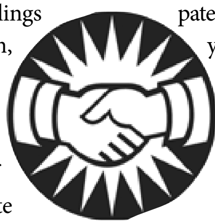
The Master Mediator

Having Second Thoughts? How Regret Motivates Settlement Decisions

BY ROBERT A. CREO

What is at the heart of regret?

Regret is a negative emotion and is classified as a subcategory of sadness. It can be linked to feelings of shame, embarrassment, depression, annoyance, or guilt—although regret is considered to be distinct from guilt. Scientists contend that guilt is a much deeper emotional form of regret, and is derivative or subordinate in terms of emotional valence or intensity.



Although often used interchangeably, regret and remorse are not the same. Remorse has a stronger nexus to specific past actions that are considered by society, or in relationships, to be hurtful, shameful, or violent. Remorse is coupled with acknowledgement, redemption, and apology.

Regret bounces around us internally as we reflect on our decisions, actions, and omissions.

Anticipated regret is common. Research indicates that people tend to overestimate how much regret they will feel in the future based upon their decisions and actions. Many contend that anticipated regret—about how badly you think you will feel—is overestimated probably since bad outcomes can be attributed to luck, unusual conditions, actions of others, or other external factors, rather than to internal shortcomings.

Buyer's Remorse is really Buyer's Regret. And Seller's too.

MEDIATION FORGIVES

Metaphorically, that is what we often do as mediators: deal with the anticipated regret of all participants by … anticipating it. Regret is massaged at every possible step we see it, including our own.

In my early days as a mediator, more experienced mediators claimed that mediation is a forgiving process. The message was not to beat yourself up with regret for what you said, or didn't say, during the sessions. Just move forward and make your next move, and generally phrase your answer in the form of a question.

It's good advice to mediators then, and now. So, where does regret thrive, or hide, in mediation sessions?

My experience with participants is that regret can choke off the proverbial light at the end of the tunnel, as choices are narrowed and it's time to decide. Regret is usually the last emotional barrier precluding resolution. No lawyer or client wants to leave money on the table. Most people avoid suffering a sure loss over accepting a future risk, which is known as prospect theory.

Lawyers contest all facts, behaviors, and decisions with the clearer vision of hindsight. Bluster too easily morphs into the zealous advocacy of the lawyer code of professional responsibility. "Getting to yes" is typically tinged with doubt, especially when opposing attorneys congratulate you on the great deal you just made for your own side at the expense of their clients.

HOW NOT TO 'LET IT GO'

The phrase "Let it Go" and regret are intrinsically linked. They are two-sides of the Choice Coin, which is heavily affected by cognitive biases. University of Chicago Prof. Richard Thaler, who had cameo role in the hit movie, The Big Short, explaining the 2008 financial crisis, coined the term the Endowment Effect.

It is a basic concept: people's valuation of a right or asset is not objective and consistent but is dependent on the context of possession or ownership. The Endowment Effect holds that people demand more to give up the right or asset they have than the same individual would pay to acquire it.

Author Daniel Kahneman, when accepting his Nobel Prize in 2002, recognized the effects in studying this cognitive bias. He noted that the existing situation becomes a "referent transaction" which creates an entitlement mentality; any diminishing of this entitlement

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